TEA

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August 15, 2013

Annette Cluff, Superintendent
The Varnett Public School
PO Box 1457
Houston, TX 77251-1457

Subject: Final Investigative Report, The Varnett Public School #101-814

Dear Ms. Cluff:

Enclosed are the final results of an investigative visit conducted by Texas Education Agency (TEA) auditors. The visit was conducted from March 7 to March 11, 2011. Auditors investigated a complaint against the Varnett Public School and also reviewed the school's compliance with the American Recovery and Reinvestment Act of 2009 (ARRA) requirements for the 2009–2010 and 2010–2011 school years.

This final report includes the findings and required actions provided in the preliminary report, descriptions of your charter school's responses, analyses of those responses, and the agency's planned actions with regard to the report findings. The enclosed CD includes the exhibits and appendices from the preliminary report.

If you have any questions, please contact Mike Richmond in the Division of Financial Compliance at (512) 475-3403 or mike.richmond@tea.state.tx.us.

Sincerely,

Lisa Dawn-Fisher, Ph.D.
Associate Commissioner
School Finance/Chief School Finance Officer

LDF/dm
Enclosure

c: Special Invetigations Unit, TEA
Enforcement Coordination and Governance, TEA
Office of Accreditation and School Improvement, TEA
Office of Grants and Federal Fiscal Compliance, TEA

Special Accreditation Investigation
March 7–11, 2011
The Varnett Public School

Executive Summary

The Varnett Public School responded through its attorney to the agency's preliminary investigative report dated June 1, 2012. The response did not include any additional documentation to support the charter school's position challenging the preliminary report's findings. Therefore, the agency stands by its finding that the charter school did not consolidate its federal, state, and local funds in accordance with applicable federal law, and the school's federal funds remain in question. The agency also stands by the report's numerous other findings. Overall, the charter school board has failed to provide adequate oversight and to safeguard the public funds generated by the students of the Varnett Public School. The board allowed the superintendent and the facilities and operations manager to enrich themselves through related-party contracts and the improper use of school funds, and it failed to ensure that the school's financial and accounting system and financial practices comply with state and federal law and regulation.

Final Report of Investigative Review
March 7–11, 2011
The Varnett Public School

The exhibits in this report contain examples of investigative findings and are not all-inclusive. The auditors reviewed financial records and conducted interviews with the superintendent, charter school administrators, and other employees.

Background
The Varnett Public School (VPS) began operations on September 1, 1998, in Houston, Texas. It is approved by the Texas Education Agency (TEA) to educate children from prekindergarten to sixth grade. The VPS currently has three campuses, referred to as Northeast, East, and Southwest, with the largest being the Southwest campus, at 5025 Willow Drive. The approximate enrollment in fiscal year 2011 was 1,667 students. The charter school's overall academic rating for fiscal year 2010 was Exemplary. The East campus was recognized as a National Blue Ribbon School in 2010. The school is operated by M. Annette Cluff, the superintendent and founder.

Other Circumstances
The auditors' specific findings are given below. Certain circumstances within the charter school are also relevant.

The following relationships exist between charter school employees and corporations that interact with the charter school:

- The superintendent is married to the facilities and operations manager (Alsie Cluff Jr.).
- The superintendent and her husband own Varnett Academy Inc., a real estate company, and Texas School Bus Company, a bus company.
- The superintendent serves on the board for the charter holder, Varnett Charter School, Inc. (hereafter "charter holder").
- The facilities and operations manager serves on the charter school board.
- Melissa Cluff is the assistant director of prekindergarten, and the daughter of the superintendent and the facilities and operations manager.
- Alsie Cluff III is the son of the superintendent and the facilities and operations manager, and was also employed with the school in various capacities before resigning in February 2011.

For fiscal year 2011, the superintendent's salary was $264,600, and the facilities and operations manager's salary was $175,165.70. The superintendent's salary was the 21st highest salary of the 1,154 superintendents in Texas. In July 2009, the board authorized a $100,000 tax-free bonus to the superintendent, representing a $10,000-per-year bonus to her salary from 1999 to 2009. According to the board, the bonus was given for providing outstanding leadership and dedication to the Varnett Public School, its students, and its parents; the school's achievements on the state assessment tests; her management of the school's financial assets and employees; and her involvement in the community.

The superintendent and her husband serve on the charter holder board and the charter school board. Through their influence and active participation, the charter school uses an accounting system that is not in compliance with Module 1.5.4 of the *Financial Accountability System Resource Guide* (*FASRG*) and has entered into related-party contracts that benefit them financially. They have also participated in questionable financial practices, such as donating money to other nonprofit organizations and charging school supplies and large school-related expenditures to their personal credit cards. Segregation of duties is a key concept of internal

control that ensures the validity of financial transactions. At the VPS, segregation of duties is greatly weakened by the family and business relationships of its employees. Additionally, the board of trustees does not scrutinize the charter school's financial transactions and contracts. All of these circumstances greatly weaken and compromise the internal control structure of the charter school. See Module 1.5 of the *FASRG* and Module 1.5 of the *Special Supplement to the Financial Accountability System Resource Guide, Charter Schools*.

TEA AUDITOR FINDINGS—INVESTIGATION OF COMPLAINT

The following findings address the allegations raised in a complaint filed with TEA, as well as other issues that came to the attention of the auditors during the course of their investigation. These findings also demonstrate the charter holder's and charter school board's failure to properly exercise their fiduciary responsibility over the charter school's assets and the public funds expended by the charter school.

Federal Programs

Concern

The charter school does not meet federal requirements for consolidating federal and state funds through a schoolwide program, time and effort reporting, and allowable expenditures.

Statutory, Regulatory, and/or Contractual Authority

US Department of Education nonregulatory guidance *Designing Schoolwide Programs, March 2006.*

Public Law 107-110, §1114(b)(2)(A).

34 Code of Federal Regulations (CFR), §200.26(b) and §200.27(a)(3).

Office of Management and Budget (OMB) Circular A-122, Attachment B(8)(m) (see Appendix A).

Finding

The charter school failed to meet federal requirements for consolidating federal and state funds through a schoolwide program, time and effort reporting, and allowable expenditures.

Investigative Summary

1. The US Department of Education's nonregulatory guidance *Designing Schoolwide Programs, March 2006* states, "Schoolwide programs schools use Title I funds to meet the needs of all students in the school, as determined through a comprehensive needs assessment."

   According to P.L. 107-110, §1114(b)(1)(A), a school operating a schoolwide program must conduct a comprehensive needs assessment that identifies the school's strengths and challenges in key areas that affect student achievement.

   According to P.L. 107-110, §1114(b)(2)(A); 34 CFR, §200.26(b); and 34 CFR, §200.27(a)(3), the school must develop a comprehensive schoolwide plan in consultation with the local educational agency (LEA) and its school support team or another technical assistance provider and the school community. The comprehensive plan must be based on data from a comprehensive needs assessment or, for schools that have operated schoolwide programs for an extended period of time, based on the state's annual assessments and other indicators of academic achievement. The comprehensive plan must (1) describe how the school will implement the schoolwide program components listed under 34 CFR, §200.28; (2) describe how the school will use resources to implement the schoolwide program components; (3) include a list of state educational agency,

LEA, and other federal programs for which the school will consolidate funds to use in its schoolwide program; and (4) describe how the school will provide individual student academic assessment results to parents.

The auditors' review of the charter school's improvement plan, its campus improvement plans, and the consolidation fund plan, as well as discussions with school personnel, identified the following issues:

a) The VPS was not in compliance with P.L. 107-110, §1114(b), because no comprehensive needs assessment was performed to help identify the school's strengths and challenges in key areas that have an impact on student achievement.

b) The VPS did not ensure development of a required schoolwide improvement plan that included all the elements required by P.L. 107-110, §1114(b)(2)(A).

Using TEA's eGrants system, the auditors reviewed the school's Consolidated Application for Federal Funding for School Year 2010–2011. They noted that on Schedule PS3211, the VPS checked the activities it planned to conduct for program coordination, and checked activity 8, which states that the comprehensive needs assessment is included in the campus improvement plan and part of the planning process. However, when the auditors reviewed copies of the schoolwide campus improvement plans, they noted that the required comprehensive needs assessment (for school years 2008–2009, 2009–2010, and 2010–2011) was not included (see Exhibit 1).

Consequently, there is no evidence that the Title I, Part A, funded campus goals and strategies were (1) developed based on the analysis of the needs assessment, (2) designed to increase student achievement, and (3) based on scientifically based research (see Exhibit 1 for specific findings).

Therefore, the VPS failed to demonstrate that it implemented the required program elements mandated in P.L. 107-110, §1114(b)(1), which effectively undermines the legitimacy of the grant. TEA is therefore questioning all funds associated with the schoolwide program for 2008–2009, 2009–2010, and 2010–2011.

Below is a list of the programs consolidated in the schoolwide program and the amounts in question:

Fiscal Year 2009				
Fund #	Program Name	NOGA ID#	Award Amount	Amount in Question
211	Title I, Part A	09610101101814	$721,064	$721,064
224	IDEA-B Formula	096600011018146600	$224,069	$224,069
255	Title II, Part A	09694501101814	$116,977	$116,977
263	Title III, Part A	09671001101814	$36,733	$36,733
204	Title IV, Part A	09691001101814	$8,742	$8,742
262	Title II, Part D	09630001101814	$6,634	$6,634
			Total for Fiscal Year 2009	**$1,114,219**

Fiscal Year 2010				
211	Title I, Part A	10610101101814	$833,717	$833,717
224	IDEA-B Formula	106600011018146600	$205,327	$205,357
255	Title II, Part A	10694501101814	$123,825	$123,825
263	Title III, Part A	10671001101814	$42,846	$42,846
204	Title IV, Part A	10691001101814	$9,635	$8,722 ($9,635

				NOGA)
262	Title II, Part D	10630001101814	$7,259	$7,259
279	Title II, Part D, ARRA	10553001101814	$20,362	$19,686
285	Title I, Part A, ARRA	10551001101814	$549,166	$585,837
283	IDEA-B Formula, ARRA	10554001101814	$321,800	$280,313
266	ARRA Title XIV, SFSF	10557001101814	$235,198	$235,198
			Total for Fiscal Year 2010	**$2,342,760**

Fiscal Year 2011				
211	Title I, Part A	11610101101814	$833,771	$797,866
224	IDEA-B Formula	116600011018146600	$235,754	$212,580
255	Title II, Part A	11694501101814	$129,859	$125,198
263	Title III, Part A	11671001101814	$54,233	$51,581
	Title III, Part A, Immigrant	11671003101814	$22,696	$21,561
204	Title IV, Part A	10691001101814		$1.00
262	Title II, Part D	10630001101814		$1.00
279	Title II, Part D, ARRA	10553001101814		$19,686
285	Title I, Part A, ARRA	10551001101814		$585,837
283	IDEA-B Formula, ARRA	10554001101814		$330
			Total for Fiscal Year 2011	**$1,814,641**
			Total Amount	**$5,271,620**

2. The VPS did not maintain time and effort documentation in accordance with OMB Circular A-122, Attachment B(8)(m). The charter school could not provide the auditors with signed semiannual certifications of activity from employees who worked on a single federal award, or signed monthly personnel activity reports for employees whose salary or wages were funded by more than one federal award or nonfederal source. The superintendent told the auditors that time and effort was not maintained because the federal programs are coded to 8911 and all campuses qualify to be Title I schoolwide. See Appendix A for the actual federal regulation.

   Accordingly, the charter school did not maintain adequate documentation to comply with federal requirements for payroll-related expenditures under a schoolwide program. Because the charter school did not maintain time and effort documentation for employees who provide services under a federal program, all payroll costs for school years 2008–2009, 2009–2010, and 2010–2011 are considered questioned costs. The amounts in question are given below. *Please note that the costs below are a subset of the grant funds questioned in the finding above and are included in the total amount in question.*

Fiscal Year 2009			
Fund Code	Program Title	NOGA ID #	Total Payroll Amount
211	Title I, Part A	09610101101814	$326,312.13
224	IDEA-B Formula	096600011018146600	$112,111.37
		Total for Fiscal Year 2009	**$438,423.50**

Fiscal Year 2010			
Fund Code	Program Title	NOGA ID #	Total Payroll Amount

283	Title II, Part A	11694501101814	$273,684.71
224	IDEA-B Formula	10660001101814 6600	$105,201.57
		Total for Fiscal Year 2010	**$378,886.28**

Fiscal Year 2011			
Fund Code	Program Title	NOGA ID #	Total Payroll Amount
283	IDEA-B Formula, ARRA	10554001101814	$330.00
224	IDEA-B Formula	10660001101814 6600	$77,959.02
263	Title III, Part A	11671001101814	$23,899.76
255	Title II, Part A	11694501101814	$53,055.00
		Total for Fiscal Year 2011	**$155,243.78**
		Total Amount	**$972,553.56**

3. Documents provided by the VPS indicate that the school has used Title I, Part A, funds for costs that are not allowable. Specifically, the VPS used these funds to pay for landscaping, janitorial services, and utilities at all three campuses. The auditors are questioning these costs based upon federal guidelines.

   "Guidance for the Implementation of Title I, Part A Improving Basic Programs Operated By Local Education Agencies," distributed by the TEA's No Child Left Behind (NCLB) Act program, states that:

   > Title I, Part A funds (as well as consolidated federal funds) must be used to address the educational needs of a school identified by the needs assessment and articulated in the comprehensive plan. [Section 1114(a)(1)] Accordingly, they may not be used for non-educational activities such as building maintenance and repairs, landscaping, and custodial services.
   >
   > When Title I, Part A funds are consolidated with state and local funds as described in E-2 and E-3, they lose their identity; thus, it is impossible to know on what specific activities Part A funds are spent. However, to meet the supplement not supplant requirement as it relates to a schoolwide program, an LEA must ensure that each school operating a schoolwide program receives all the state and local funds it would otherwise need to operate in the absence of federal funds [Section 1114(a)(2)(B)], including state and local funds necessary to provide for routine operating expenses such as building maintenance and repairs, landscaping and custodial services. Thus, even though Title I, Part A funds are included in the consolidated pool of resources available to the school that may support, for example, building maintenance and repair, landscaping, or custodial services, there must also be sufficient state and local funds in that consolidated pool to cover non-educational activities.

   Accordingly, the landscaping, janitorial service, and utility costs that the VPS paid for using Title I, Part A, funds do not appear to be allowable costs. Title I, Part A, funds must be used to address the educational needs of students and may not be used for building maintenance and repair, landscaping, or custodial repairs unless there are sufficient state and local funds in the consolidated pool to cover noneducational activities. The charter school's consolidation plan did not include state and local funds and only consisted of federal funds. Additionally, the VPS is in violation of the federal supplement not supplant provision. This provision is

intended to ensure that services provided under Title I are used to supplement (increase the level of services) and not supplant (replace) services that would otherwise be provided to students with state and local funds if Title I funds were not available. State or local funds may not be decreased or diverted for other uses merely because of the availability of Title I funds.

The questioned costs involving the landscaping and janitorial services are given in this table:

Fiscal Year 2010				
Fund	Program Title	NOGA ID#	Account Code	Amount
211	Title I, Part A	09610101101814	51-6249	$278,588
211	Title I, Part A	09610101101814	51-6319	$372,925
			Total for Fiscal Year 2010	**$651,513**

Fiscal Year 2011 (through February 28, 2011)				
Fund	Program Title	NOGA ID#	Account Code	Amount
211	Title I, Part A	11610101101814	51-6249	$154,084
211	Title I, Part A	11610101101814	51-6319	$38,159
			Total for Fiscal Year 2011	**$192,243**
			Total Amount	**$843,756**

Additionally, TEA is questioning the utility costs for the three campuses as follows: $135,396.83 in 2008–2009, $39,814.97 in 2009–2010, and $44,340 in 2010–2011. *Please note that the utility costs and the amounts in the table above are a subset of the grant funds questioned in finding 1 above and are included in the total amount in question.*

Summary and Analysis of Charter School's Response:

1. **The VPS asserted that it was not required to conduct a comprehensive needs assessment or comprehensive plan for 2009, 2010, and 2011 because the LEA is required to perform the needs assessment only once when it originally implements or amends its consolidated schoolwide program. The VPS stated that, using P.L. 107-110, §1114, as guidance, it completed the plan in November 2000 and revised it continuously beginning in 2003. The VPS further stated that its independent auditor, Gomez & Company, reviewed the school's State Compensatory Education Requirements and as part of that review determined that the schoolwide and campus improvement plans contained all the required components to qualify for a consolidated schoolwide program. The charter school asserted that the NCLB Act places emphasis on the substance of the plan not the form and that both TEA and the independent auditor have confirmed that.**

   The charter school did not provide any additional documentation—such as, at a minimum, its original and amended comprehensive needs assessment plan—to support the school's stance that it complied with P.L. 107-110, §1114, when it first implemented a schoolwide program. Based on the documents provided during the initial investigation, this finding stands, and the amounts in question remain in question.

2. **The VPS stated that OMB Circular A-122 does not apply to the charter school because it consolidates its federal, state, and local funds and that, instead, OMB Circular A-87 applies. OMB Circular A-87 exempts LEAs that consolidate federal, state, and local funds from filing semiannual certifications, because there is no distinction between the types of funds used to pay employees.**

   The charter school did not provide any additional documentation to support its assertion. Based on the documents provided during the initial investigation, this finding stands, and the amounts in question remain in question.

3. **The VPS claimed that the rules for Title I, Part A, do not apply because it consolidates federal, state, and local funds. The school further claimed that since it consolidates funds, it can use the funds for any activity as long as the funds are used to supplement and not supplant.**

   The charter school did not provide any additional documentation to support its assertion. Based on the documents provided during the initial investigation, this finding stands, as do the questioned costs.

Conflict of Interest in a Sale-and-Leaseback Transaction

Concern	The charter school's governing board breached its fiduciary duty to use state funds solely for the benefit of its students by engaging in a sale-and-leaseback transaction involving the administration building located at 11211 Clematis Lane. In addition, the superintendent and the facilities and operations manager used their positions in the school and on the board to influence the sale and subsequent leaseback of the building.
Statutory, Regulatory, and/or Contractual Authority	Texas Penal Code (TPC), §39.02, Abuse of Official Capacity (see Appendix B). TPC, §32.45, Misapplication of Fiduciary Property (see Appendix C). 19 Texas Administrative Code (TAC) §100.1043, Status and Use of State Funds; Depository Contract (see Appendix D).
Finding	The superintendent and the facilities and operations manager have a conflict of interest relating to the administration building located at 11211 Clematis Lane. The board failed to act in the best interest of the charter school's students by allowing the sale-and-leaseback transaction to be approved.
Investigative Summary	The Southwest VPS campus is leased from Varnett Academy Inc., a real estate company owned and operated by the superintendent and the facilities and operations manager. An elementary school, centralized child nutrition kitchen, prekindergarten school, and administration building are located on this property. Each building has a separate lease with the real estate company. For the 2010–2011 school year, these lease agreements totaled approximately $1,034,876. In the summer of 2008, the charter school contracted with CoMark Building Systems Inc. to construct a prefabricated administration building at 11211 Clematis Lane for $448,654. The charter school incurred an additional $167,803 in construction-related expenses for preparing the facility for occupation in the

summer of 2009. These expenses included electrical services, a foundation, a detention pond, gutters, and a sound system. This work was completed in spring 2009, and the vendor invoices were reviewed by the auditors.

The minutes for the July 2009 board meeting indicate that the VPS board of directors passed a board resolution allowing the VPS to sell the newly constructed building to Varnett Academy Inc. for $426,221.30. The resolution stated that Varnett Academy Inc. would also pay the remaining balance of $22,432.70 owed to CoMark. In August 2009, Varnett Academy Inc. leased the administration building back to the VPS for $211,478.64 annually, so in essence, the charter school provided a loan to a private corporation (see Exhibit 2).

In February 2010, the board passed another resolution allowing the charter school to be reimbursed for leasehold improvements noted in the charter holder's 2009 annual financial and compliance report (Note Disclosures, letter H). The report indicated that Varnett Academy Inc. purchased the administration building from the VPS for $594,024, which is different from the amount given in the July 2009 board resolution, and also included a receivable amount of $167,803 from Varnett Academy Inc., which was the cost of the leasehold improvements. The payment was received and deposited into the charter school's bank account.

The charter school had a material weakness in internal control that may have allowed its officers and employees to violate TPC, §39.02, Abuse of Official Capacity (see Appendix B), and §32.45, Misapplication of Fiduciary Property (see Appendix C). Because the superintendent of the charter school and the facilities and operations manager serve as the president and vice president of the real estate company, they were able to involve the charter school in a sale-and-leaseback transaction that benefitted them personally. The leaseback allowed them to recoup the building costs for the administration building in less than three years.

The superintendent provided the auditors a market study conducted on the administration building that shows that the charter school's lease payments for the building appear to be at the market rate, but there is no evidence that the board conducted any analysis to determine if the lease agreement was in the best interests of the charter school.

The board's failure to consider alternatives to the sale-and-leaseback transaction unreasonably diminished the charter school's bargaining power in that transaction. Therefore, the board breached its fiduciary duty per 19 TAC §100.1043 to use public funds exclusively for the benefit of the charter school's students (see Appendix D).

Summary and Analysis of Charter School's Response:

The VPS disagreed with this finding. In its response, the charter school provided the ownership history of the Southwest campus, in which the administration building is located. The charter school stated that its accountant suggested that the VPS sell the building at cost to Varnett Academy Inc. because Varnett Academy Inc. already owned the land that the building was on. After purchasing the building from the VPS, Varnett Academy Inc. hired an appraiser to determine the appropriate monthly lease amount based on current market conditions. The charter school pointed out that both M. Annette Cluff and Alsie Cluff Jr. (the Cluffs) abstained from voting on the transaction and in May 2012

Varnett Academy Inc. sold the campus to the VPS. The charter school did not provide any documentation to support its statements.

The finding that the board was not acting in the best interest of the students and allowed the charter school to loan public funds to a privately owned related-party entity stands. The board and the administrators were both aware that the charter school did not own the land but allowed the sale-and-leaseback transaction to happen, enriching the superintendent and facilities and operations manager with 34.5 percent of the total sales price in annual lease payments.

Transportation Contract

Concern	The governing board of the VPS violated its fiduciary responsibilities to the charter school by approving a related-party transportation agreement between the charter school and the Texas School Bus Company.
Statutory, Regulatory, and/or Contractual Authority	TPC, §39.02, Abuse of Official Capacity (see Appendix B).
Finding	The superintendent, the facilities and operations manager, and the school board failed to act in the best interest of the students by approving a related-party transaction between the charter school and the Texas School Bus Company. The company is owned by the superintendent and the facilities and operations manager.
Investigative Summary	During the 2003–2004 school year, the charter school contracted with the Texas School Bus Company, which is owned by the superintendent and the facilities and operations manager. The current contract states that the bus company will provide daily transportation to charter school students at the three campuses. The charter school leases 12 buses from the bus company at a rate of $413.40 per day, per bus, for 184 school days, for a total amount of $912,787.20 for the school year. The school pays a fuel surcharge of $17,426.02, and the contract includes a provision that if the fuel cost in any quarter exceeds that of the first annual quarter by 10 percent, the bus company can apply additional fuel surcharges. The contract also states that the Texas School Bus Company is responsible for the fuel, drivers, and ordinary wear and tear on the buses, with the exception of damage caused by students, teachers, agents, or subcontractors (see Exhibit 3). TEA auditors requested information that would help them determine whether the charter school researched other bus companies, and whether the contract was an arm's length transaction. The charter school was unable to provide any evidence that research was conducted to find the best deal for the school and recommended that the auditors call other companies that provided similar services to get a comparison quote. The auditors reviewed a report generated by TEA's Division of State Funding that lists the school districts and charter schools in Texas that reported transportation costs and mileage. The VPS has the highest cost per mile in Harris County and in the state of Texas. Below is a list of the charter schools located in Harris County

that reported to TEA and their transportation costs per mile for the 2009–2010 school year:

District Number	Charter School Name	Cost per Mile	Total Miles	Operated By
101814	The Varnett Public School	$12.37	79,231	Contractor
101849	Accelerated Intermediate Academy	$7.32	23,982	Contractor
101850	Zoe Learning Academy	$5.50	58,205	Contractor
101851	Houston Alternative Preparatory Ch	$4.64	34,492	Contractor
101845	Yes Prep Public Schools Inc.	$4.08	608,737	Contractor
101813	Kipp Inc. Charter	$3.16	711,055	Contractor
101860	Kipp Southeast Houston	$2.94	157,340	Contractor
101804	George I. Sanchez Charter	$2.77	28,692	School
101837	Calvin Nelms Charter Schools	$2.00	42,003	School
101822	Jamie's House Charter School	$1.44	56,782	School
101806	Raul Yzaguirre School For Success	$1.72	Not reported	

The table below displays the charter school's transportation costs and changes to these costs over fiscal years 2007, 2008, 2009, and 2010.

Fiscal Year	Total Cost	Total Miles	Cost per Mile	# of Buses	# of Routes	# of Riders	Change $	Change %	Change $	Change %
2010	$980,268	79,231	$12.37	12	11	1167	132,600	14%	(33,784)	–43%
2009	$847,668	113,015	$7.50	11	11	1113	12,918	2%	(26,808)	–24%
2008	$834,750	139,823	$5.97	11	11	974	283,021	34%	(14,909)	–11%
2007	$551,729	154,732	$3.57	9	9	987				

Based on the trends in the table above, it appears that the total mileage for the VPS has decreased each year beginning in fiscal year 2007, while the ridership and cost of the contract increased. The cost per mile has quadrupled over four years.

TEA auditors also noted that the Texas School Bus Company has charged the VPS for use of its buses for field trips and other activities not listed in the contract. The auditors noted one Texas School Bus Company invoice with charges that appear to be unrelated to the transportation of students. One charge was for teachers to tour the neighborhood, and the other was to take teachers to a funeral on August 26, 2010 (see Exhibit 4).

In summary, the governing board of the charter school failed to act in the best interests of the charter school when it did not research other companies that may provide transportation services for prices that are comparable to what other charter schools in Harris County are charged. The board abdicated its oversight role and did not monitor the charter school's financial operations.

The superintendent and the facilities and operations manager may have violated TPC §39.02, Abuse of Official Capacity, because they serve on the boards that control the charter school and are key decision makers of the charter school and

they benefited personally from the transportation contract between the company they own and the charter school.

Summary and Analysis of Charter School's Response:

The VPS disagreed with this finding. In its response, the charter school stated that, after contracting with a bus company for several years, it became dissatisfied with the company's services and decided to find another company. However, in its search for a new bus company, the charter school did not find one that met all the charter school's criteria, such as displaying the name of the school on the outside of the buses. Consequently, the Cluffs started their own bus company, the Texas School Bus Company. The charter school stated that each year the school contacted other bus companies to find out their rates and determined that the Texas School Bus Company rates were comparable to those of other companies. In May 2012, the Texas School Bus Company sold its buses to the VPS. The charter school stated that when the board voted to contract with the Texas School Bus Company, the Cluffs abstained from voting.

Regarding the use of school buses for nonstudent activities and for purposes not provided for in the contract, the charter school stated that the activities involving teacher transportation were indirectly related to the school because they gave the teachers perspective about where their students are coming from and a sense of family outside of the school building.

The charter school did not provide any additional documentation to support its position and statements. The finding that the board neglected its fiduciary responsibilities to the students of the charter school by approving a related-party transportation agreement stands.

Annual Governance Reporting Form

Concern	The charter school superintendent did not accurately disclose information on the 2009–2010 and 2010–2011 Annual Governance Reporting Forms for Open-Enrollment Charter Schools.
Statutory, Regulatory, and/or Contractual Authority	TPC, §37.10, Tampering with a Governmental Record (see Appendix E).
Finding	The superintendent failed to disclose the related-party contracts and the use of school vehicles for personal and business use on the Annual Governance Reporting Forms for Open-Enrollment Charter Schools.
Investigative Summary	The superintendent and the facilities and operations manager have a business relationship with the charter school. The bus company that they own provides transportation services for the students of the charter school, and the real estate company that they own leases the Southwest campus to the charter school. The charter school provides the superintendent and the facilities and operations manager with vehicles intended for school-related business. These vehicles are

also driven for personal use.

In the governance reporting document provided in Exhibit 5, the superintendent replied "none" to statements in the document that are intended to acknowledge "all compensation received for goods or services under contract, agreement, informal arrangement, or otherwise" (statement 3), "the fair market value of all personal use of property paid for by the charter holder or charter school" (statement 6), and "all other forms of compensation or remuneration received by the individual from charter holder or the charter school" (statement 9). The superintendent and facilities and operations manager should have disclosed on the governance reporting form the compensation they receive from their business relationship with the charter school, and their personal use of the school's vehicles. Failing to disclose such information on the form, which is certified under penalty of perjury, may be a violation of §TPC, 37.10.

Summary and Analysis of Charter School's Response:

The charter school disagreed with the finding. It stated that the superintendent and facilities and operations manager answered the governance questions in good faith and, if the questions were answered incorrectly, it was not by intent. The charter school took the position that the questions were answered correctly. The VPS also stated that the vehicles the school purchased for the superintendent and facilities and operations manager are driven for business purposes only and that the board voted on the purchase without the superintendent's or manager's knowledge. The charter school's response referred to board minutes recording approval of the purchase; however, the minutes were never provided to TEA.

The charter school did not provide any documentation to support its statements. The finding stands.

Open Meetings Act

Concern	The charter school violated the Open Meetings Act by holding meetings at locations which the public had limited access to.
Statutory, Regulatory, and/or Contractual Authority	Texas Government Code, Chapter 551, Open Meetings (see Appendix F).
Finding	The charter school violated Texas Government Code, Chapter 551, Open Meetings, by holding meeting at locations which the public had limited access to.
Investigative Summary	According to board meeting minutes provided by the VPS, the charter school held board meetings on a cruise ship, in restaurants, and over the phone. Each incident constitutes a violation of the Open Meetings Act (see Appendix F). According to Texas Government Code, §551.002, "Every regular, special, or called meeting of a governmental body shall be open to the public. . . ." In addition, the charter school failed to notify the public of the location of these board

meetings, violating §551.051, which says that "[a] school district shall post notice of each meeting on a bulletin board at a place convenient to the public in the central administrative office of the district."

The table below lists the board meetings that were in violation of the Open Meetings Act:

Date	Board Meeting Location
November 22, 2008	The Fearrington House (hotel), Pittsboro, North Carolina
December 14, 2008	Lancaster Hotel
January 9, 2009	Telephone conference call
January 11, 2009	Telephone conference call
January 16, 2009	Telephone conference call
February 6, 2009	Telephone conference call
March 9, 2009	Telephone conference call
August 26, 2009	Telephone conference call
October 10, 2009	Bourbon Orleans Hotel, New Orleans, Louisiana
June 3, 2010	Brady's Landing (restaurant)
March 9, 2010	Telephone conference call
August 11, 2010	Telephone conference call
January 28, 2011	Carnival cruise ship

Additionally, the charter school may have violated the Open Meetings Act on March 7, 2011, when two members of the charter holder board and one member of the charter school board met with the auditors for this investigation. The presence of two of the members of the charter holder board resulted in a quorum, thus necessitating an agenda and requiring the meeting to be posted for public notification. Even though this meeting was planned in advance, it lacked an agenda and was not posted, a violation of both §551.002 and §551.041 of the Texas Government Code.

Summary and Analysis of Charter School's Response:

The VPS stated that the Texas Open Meetings Act did not apply to the school for 2009–2010 because the school was exemplary and, under the Texas Education Code (TEC), §39.232, a school that is rated exemplary is exempt from complying with most requirements of the TEC. The VPS asserted that it did not violate the Texas Open Meetings Act because the act does not preclude a meeting from being held in another state as long as the meeting is accessible to the public. The VPS also stated that the board provided proper notice of its board meetings. The charter school did concede that it technically violated the Texas Open Meetings Act when it held board meetings by conference call, but not knowingly. The charter school said that it did not violate the Texas Open Meetings Act when two charter holder board members met with TEA auditors because the meeting did not meet the five criteria for a meeting provided in the act.

TEA notes that the TEC, §39.232, exempts certain LEAs only from TEC requirements and not from Texas Open Meetings Act (Texas Government Code) requirements. Also, the charter school did not provide any additional documentation. The finding stands.

Disbursement of Funds

Concern	The VPS did not maintain sufficient documentation for disbursements of funds.
Statutory, Regulatory, and/or Contractual Authority	*FASRG*, Module 1.8.2.6.5 of the *Special Supplement to the Financial Accountability System Resource Guide, Charter Schools* (see Appendix G). TEC, §12.107, Status and Use of Funds (see Appendix H). OMB Circular A-122, Attachment A(3), Reasonable Costs (see Appendix I). TPC, §39.02, Abuse of Official Capacity (see Appendix B). Texas Constitution, Article III, §52, Counties, Cities or Other Political Corporations or Subdivisions; Lending Credit; Grants; Bonds (see Appendix J). 19 TAC §100.1043, Status and Use of State Funds; Depository Contract (see Appendix D).
Finding	The VPS lacked documentary evidence to support the expenditures charged to the personal credit cards of the superintendent and the facilities and operations manager. This leads to the finding that several state and federal laws have been violated and to questioned costs in the amount of $1,504,980.51.
Investigative Summary	The charter school does not use a charter school credit card to make purchases. Instead, charter school purchases are made by the superintendent and the facilities and operations manager with their personal American Express Centurion cards (one account). At the end of each month, the superintendent reviews the credit card statement, redacts any charges that are personal and pays them with a personal check, and submits the remaining charges to the charter school to be paid. The business manager and the charter school board president review and approve the payment directly to American Express. TEA auditors reviewed all credit card statements from August 20, 2008, to January 19, 2011, and determined that $1,776,804.52 was paid by the charter school to American Express for charges made in that time period. The auditors discovered that the majority of charges lacked documentation. Receipts were not consistently attached to the statements, and while some charges had a purchase order, they lacked third-party invoices or shipping documents. Other credit card charges did not have any documentation to prove that they were school-related expenses. Charges for restaurant meals are particularly problematic, with no documentation to prove that they were school-related expenses, and no information about the number and identity of people who attended the meal. The lack of documentation indicates that the charter school is not consistently complying with generally accepted accounting standards given in Module 10 1.8.2.6.5 of the *Special Supplement to the Financial Accountability System Resource Guide, Charter Schools* (see Appendix G). In using the credit cards, the superintendent and facilities and operations manager were more likely to pay sales tax on items purchased for the school (which is a tax exempt entity), resulting in an overpayment for the items. Overall, in addition to lacking the required documentation, many of the credit card purchases appear to be personal in nature, and the costs seem excessive. Specifically, the following violations are indicated: 1. The charter school is unable to substantiate that the credit card purchases

benefited students in accordance with TEC, §12.107(a) (see Appendix H), and 19 TAC §100.1043(a)(2) (see Appendix D).

2. The charter school is unable to substantiate that the charges were reasonable and necessary in accordance with OMB Circular A-122, Attachment A(3) (see Appendix I).

These violations may indicate a misuse of public funds, which is a violation of TPC, §39.02, Abuse of Official Capacity. Additionally, the charter school extended credit to the superintendent and the facilities and operations manager by paying for their credit card charges, a violation of Article 3, §52, of the Texas Constitution, Counties, Cities or Other Political Corporations or Subdivisions; Lending Credit; Grants; Bonds.

The full extent of the credit card charges is given in Exhibit 6. Below are a few examples of charges that appear to be personal in nature:

Item	Cost
Show tickets (Broadway shows, Las Vegas shows, Disney on Ice)	$3,090.32
Mandarin Oriental (spa services)	$742.78
Bose (headphones)	$196.57
Amazon.com (two Kindle readers and accessories)	$447.98
Bolongo Bay Beach Club (restaurant, St. Thomas)	$44.45
Uptown Jewelers (Walt Disney World)	$3,484.43
Saltgrass Steakhouse (charged on a Sunday [July 19, 2009])	$340.03
Montblanc	$1,107.46
Nicky Bangkok	$676.28

The credit card charges were made for several different kinds of purchases. Some of the categories, with total amounts, are given below:

Type of Purchase	Total Amount
Transaction fees processed by American Express	$4,688.40
First class seats and business select seats for airline travel	$22,544.10
Gift cards, gifts, and prizes	$22,381.31
Airline flights, cruises, hotel stays for board members*	$22,253.52
Restaurant charges	$43,720.77
Transportation costs (such as flights, limos, shuttle buses, travel fees)	$105,038.04
Hotel charges, cruises, travel packages, and travel fees	$132,117.71
Educational materials (lacked invoices and shipping docs)	$248,704.33
Electronics (lacked invoices and shipping docs)	$369,359.59

*These charges include expenses for the board members' spouses.

Because of the numerous violations indicated, TEA auditors are questioning $1,504,980.51 of the credit card charges made by the superintendent and the operations and facilities manager and paid by the charter school.

The superintendent also disclosed that she earns points for purchases made with her American Express credit card. She indicated that she uses the points

earned to purchase airline tickets for school staff. According to Centurion benefits, card holders earn one point per dollar spent. Subsequently, purchases made on behalf of the charter school contributed to the points earned, which resulted in approximately 1,500,000 points during the period reviewed.

Summary and Analysis of Charter School's Response:

The charter school disagreed with the finding. The VPS stated that it did not have its own credit card because TEA employees advised charter schools to not have credit cards in their names. *In fact, TEA advises charter schools to limit the use of credit cards because using credit cards more easily allows for misuse of school funds than using purchase orders does, and using credit cards does not have as many controls.*

The VPS stated that the credit card expenditures do not violate TEC, §12.107, because federal funds and unrestricted funds are not Foundation School Program (state) funds and therefore the statute is not applicable. This assertion is false. Given that the school commingles its funds, there is no way to determine that only unrestricted funds were used to pay for the credit card charges that were not a benefit to the students. Additionally, federal and state guidelines also restrict the use of school funds.

The charter school stated that it has received over $1.8 million in unrestricted funds from 1998 through 2011, which exceeds the amount of questioned costs for the unsupported credit charges and therefore negates this finding. This assertion is problematic since, because the school commingles its funds, the school cannot determine which funds were unrestricted. Even if the school did receive over $1.8 million in unrestricted funds, that amount may not be enough to pay for all the personal charges over the 13-year period given that the questioned costs for just the two-and-a-half-year period TEA auditors reviewed totaled over $1 million. Additionally, the auditors review of the school's annual financial reports indicates that the local funds included interest earned from the bank. The interest earned on state funds is property of the state and is therefore subject to the same restrictions as other state funds. TEA auditors did not review any purchases made before 2008.

The VPS stated that there is a conflict between the *FASRG* and NCLB Act guidance in that the *FASRG* explicitly requires documentation to support the disbursement of funds while 34 CFR, §80.20, does not. It argued that, because the US Supremacy Clause of the US Constitution dictates that federal statutes and regulations control over state administrative protocol, 34 CFR, §80.20, which does not require documentation, controls. The agency notes that the Supremacy Clause addresses *conflicts* and that, in this instance, the *FASRG* simply makes more specific the general documentation requirement found in 34 CFR, §80.20(c)(6). Therefore, no conflict between *FASRG* and 34 CFR, §80.20 exists.

The VPS also maintained that a credit card statement alone provides the information necessary to show that a disbursement is a final transaction between the VPS and a third party. Per the *FASRG*, which was developed based on guidance from the Committee of Sponsoring Organizations of the Treadway Commission and the American Institute of Certified Public Accountants, credit card statements alone are not adequate documentation.

The charter school stated that it did not provide any support for the specific charges in question because the school could not ascertain the underlying basis for why each cost was questioned. Although the charter school offered to provide additional documentation, none was ever submitted. As stated in the preliminary report, the expenditures were questioned because the charter school failed to provide adequate documentation that the charges were for charter school expenses and not personal.

The finding stands, and the costs remain questioned.

Travel Policies

Concern	Travel policies are not enforced by the charter school for employee and board member travel.
Finding	The charter school employees and board members failed to follow the guidelines set forth in the VPS travel policy.

Investigative Summary

According to the charter school travel policy provided by the charter school, travelers must submit travel claim vouchers that list all items in order, describe all items, describe airline fares by type of travel (such as return, one way, all-inclusive, or weekend rate), and provide the actual miles traveled for vehicle travel. Only economy rates for airline travel will be reimbursed. Receipts must be submitted with the travel claim voucher, the reason for the trip or the expenses must be described, and claims must be signed by both the traveler and the superintendent. Hotel costs over the State of Texas maximum rate (for in-state travel) or over the federal maximum rate (out-of-state travel) will not be reimbursed. Meals should be reimbursed at a rate of $36 per day or with an allotted amount reimbursed for each meal (for example, $10 for lunch). Meal expenses can only be reimbursed if an employee is outside his or her designated headquarters for longer than six hours. Charges for liquor will not be reimbursed. (See Exhibit 7.)

The travel charges made by the superintendent and operations and facilities manager with their personal credit cards are not in compliance with the charter school's adopted travel policy. Specifically:

- The American Express credit card statements of the superintendent and the facilities and operations manager show that on numerous occasions, the superintendent and certain employees flew first class or business select instead of economy class. The school paid American Express directly for the credit card charges for these seats (see Exhibit 6 for specific charges).
- The American Express credit card statements of the superintendent and the facilities and operations manager contain numerous charges to Houston-area restaurants, where meals were purchased despite the fact that the employees were not outside their headquarters for longer than six hours. Documentation regarding purpose of the meal or who attended was not provided by the charter school. The charter school paid American Express directly for these restaurant charges.
- The American Express credit card statements of the superintendent and the facilities and operations manager show that most of the hotel stays exceed the state and federal rates. The charter school paid American Express directly for

these hotel charges. This table gives a list of examples:

Date of Stay	Hotel Name/City	Charge per Night (excluding taxes)	State or Federal Rate*	Amount Paid over State or Federal Rate
November 14–17, 2010	Omni Shoreham Hotel/ Washington, DC	$279	$181	$(98)
May 12–14, 2010	Drury Plaza Hotel Riverwalk/San Antonio, TX	184.99	85	(99.99)
February 25–28, 2010	The Ritz Carlton/Charlotte, NC	219	95	(124)
October 10–11, 2009	Bourbon Orleans Hotel/ New Orleans, LA (superintendent)	299	131	(168)
October 10–11, 2009	Bourbon Orleans Hotel/ New Orleans, LA (board members)	169	131	(38)

*For fiscal year 2011, for illustrative purposes only.

Overall, the charges on the personal credit cards of the superintendent and the facilities and operations manager show numerous instances of noncompliance with the charter school's travel policy, with many charges exceeding necessary out-of-pocket expenses. In addition, the superintendent did not ensure that the charter school's policies were followed, and the board failed to provide the necessary oversight to ensure that unallowable expenditures are not reimbursed.

Summary and Analysis of Charter School's Response:

The VPS conceded that it violated its own travel policies and reimbursed all employees for expenses even if the expenses exceeded the travel policy amounts. The VPS stated that it will enforce its travel policies going forward. The finding stands.

Commingling of Funds and Records

Concern: The charter holder does not keep "separate and distinct accounting, auditing, budgeting, reporting, and recordkeeping systems for the management and operation of the charter school" to differentiate between charter and noncharter expenditures.

Statutory, Regulatory, and/or Contractual Authority:

19 TAC §100.1047, Accounting for State and Federal Funds (see Appendix K).

19 TAC §100.1043, Status and Use of State Funds; Depository Contract (see Appendix D).

TEC, §45.105(c)

Contract for Charter

Finding: The charter holder and the charter school commingled funds and failed to keep separate and distinct accounting, auditing, budgeting, reporting, and recordkeeping systems for expenditures that were related to the management and operation of the charter school and expenditures that were not.

Investigative Summary

The superintendent serves as a member of the charter holder board, and the facilities and operations manager serves as a member of the charter school board. They use their personal credit card account for both business-related and personal expenses. Because of a lack of separate accounting procedures for the charter holder, the charter school, and the employees' personal expenses, and because of a lack of supporting documentation, it is not possible to separate and categorize various charges. For example, there are charges that appear to be personal in nature because they lack documentation supporting their business purpose. Because of the lack of separate accounting procedures, however, they were paid by the charter school and entered into the school's general ledger as school expenditures. Two examples of this are the charge at Pappa's Seafood House on Saturday, December 11, 2010 (see Exhibit 8) and the charge totaling $26.95 for items from Levenger Catalog (types of products sold by Levenger include lap desks, business card holders, leather briefcases, fountain pens, and portfolios). Although the charges are small in amount, they reflect the commingling of funds between the personal accounts of the superintendent and the facilities and operations manager and the charter school's accounts.

Another example of a lack of separation of accounting records is a charge on the personal credit cards of the superintendent and the facilities and operations manager for Paychex of New York LLC for $212.62 (see Exhibit 8, page 2). The supporting documents reviewed by the auditors show an invoice for the charge, but the invoice is addressed to Varnett Academy Inc., the name of the real estate company owned by the superintendent and the facilities and operations manager. The charge was paid by the charter school and entered in its general ledger.

Having the charter school pay for credit card charges made by the superintendent and facilities and operations manager that were personal or related to another business they own is a violation of 19 TAC §100.1047, Accounting for State and Federal Funds. That regulation states that any commingling of charter and noncharter business in the accounting, auditing, budgeting, reporting, and recordkeeping systems of the charter school shall be a material charter violation. The Contract for Charter signed by the superintendent also describes the commingling of charter and noncharter business as material violation of the charter (see Exhibit 9). In addition, the governing board did not uphold its responsibilities as trustees of the public funds as stated in 19 TAC §100.1043, which constitutes a misuse and misapplication of public funds by the governing board per TEC, §45.105(c).

<u>Summary and Analysis of Charter School's Response:</u>

The VPS disagreed that using personal credit cards and having the school pay for expenses of other entities charged to those credit cards is commingling. The charter school claimed that it used the personal credit cards because it was told to do so by TEA officials when the school first began. It stated that the Pappa's Seafood House and Levenger Catalog charges were for activities of the school but did not provide any documentation reflecting that. The charter school stated that the charge on the credit card to Paychex was human error, not commingling, and that the charter school was repaid for paying the charge. The VPS also stated that its independent auditor never produced any finding related to the use of the credit cards. However, in the 2012 audit report, the auditor identified $129,820 in unsupported expenditures, which the superintendent repaid.

The charter school did not provide any additional documentation because it claimed that it was unclear what the agency was questioning. The finding stands.

Vehicles Provided by the Charter School

Concern	The superintendent and the facilities and operations manager drive vehicles owned by the charter school. The vehicles were not approved by the board or granted in their employment contracts.
Statutory, Regulatory, and/or Contractual Authority	TPC, §39.02, Abuse of Official Capacity (see Appendix B).
Finding	The superintendent and the facilities and operations manager drive vehicles owned by the charter school for both personal and business use. The vehicles were not approved by the board or granted in their employment contracts.
Investigative Summary	According to the charter school's capital asset ledger, the school purchased a 2010 truck and a 2010 Ford Taurus on January 14, 2010 (see Exhibit 10). These vehicles are driven to and from home by the superintendent and the facilities and operations manager. TEA auditors were unable to locate and were not provided with the board minutes indicating that the board had authorized this use of the vehicles. In addition, there is no specific language in employment contracts of either the superintendent or the facilities and operations manager that shows that they are authorized to drive the charter school's vehicles. The use of these vehicles constitutes benefits to the superintendent and the facilities and operations manager which should be reflected as income on their W-2 forms from the school. Without the board approval and the authorization in their employment contracts, the superintendent and the facilities and operations manager have used their positions in the school to obtain a personal benefit from the VPS, which may be a violation of TPC, §39.02(a).

Summary and Analysis of Charter School's Response:

The charter school disagreed with this finding. It stated that the board approved the purchase of vehicles for the Cluffs to use during its January 12, 2009, meeting. However, the board minutes the auditors reviewed did not reflect that.

The charter school did not submit any supporting documentation with its response. The finding stands.

Gifts of Public Funds

Concern	The charter school uses public funds to give gifts to board members and to local and national civic organizations.

Statutory, Regulatory, and/or Contractual Authority	Texas Constitution, Article III, §52 Counties, Cities or Other Political Corporations or Subdivisions; Lending Credit; Grants; Bonds (see Appendix J). TEC, §12.107, Status and Use of Funds (see Appendix H). 19 TAC §100.1043(a) (see Appendix D).
Finding	The charter school gave gifts paid for with public funds to board members and to local and national civic organizations.
Investigative Summary	In a review of documents provided by the VPS, the auditors noted that there were payments made to the Houston Citizens Chamber of Commerce, the United Negro College Fund, and the National Black Caucus. The $15,000 payment to the Houston Citizens Chamber of Commerce included $10,000 to sponsor an awards banquet and $5,000 for a lifetime membership to the Chamber. The payment to the National Black Caucus was for $25,000 in order to attend the presidential inauguration festivities. The payment to the United Negro College Fund was for $2,000 for student scholarships. Public funds given as gifts to nonprofit organizations are a violation of Article III, §52(a), of the Texas Constitution, which states that "the Legislature shall have no power to authorize any county, city, town or other political corporation or subdivision of the State to lend its credit or to grant public money or thing of value in aid of, or to any individual, association or corporation whatsoever, or to become a stockholder in such corporation, association or company." (Public funds are monies belonging to the government or any department of it that are in the hands of a public official, as defined by Black's Law Dictionary.) The charter school is responsible for holding public funds in trust for the benefit of its students. There is no evidence that the payment to the nonprofit organization benefited the charter school's students, which violates 19 TAC §100.1043(a). The payment of $25,000 to the National Black Caucus on December 2, 2008, was repaid to the charter school by the superintendent and the facilities and operations manager in January 2010, after the VPS's external auditor discovered the charge. The cost of a jukebox, which was purchased for $5,249 as a gift for a board member on November 25, 2008, has also been repaid.

<u>Summary and Analysis of Charter School's Response:</u>

The VPS response stated that the cited state statutes and regulation do not apply if the donations were made with funds other than state funds and that the donations could have been made with unrestricted funds or with funds consolidated under the NCLB Act. The school conceded that the VPS self-reported two of the donations only after its auditor discovered the gifts through a review of a credit card bill and brought them to the school's attention. The VPS stated that the payment to the Houston Citizens Chamber of Commerce was an advertising expense and not a donation. However, the invoice for the $15,000 payment showed that $10,000 went to sponsor an awards banquet and $5,000 was for a lifetime membership in the organization.

The finding stands.

Nepotism

Concern	The charter school is in possible violation of Texas nepotism and conflict of interest laws.
Statutory, Regulatory, and/or Contractual Authority	TEC, §12.1054 and §12.1055 (see Appendix L).
Finding	Because the VPS has been rated recognized or exemplary for the last three years under state accountability standards, the school is exempt from nepotism rules.
Investigative Summary	The VPS superintendent, and her husband, the VPS facilities and operations manager, serve on the charter school's governing boards. This does not violate state nepotism prohibitions given in Texas Government Code, Chapter 573, because of the charter school's state accountability rating. The school has been rated either recognized or exemplary for the last three years, so per TEC, §12.1055, it is exempt from nepotism prohibitions. Also, TEC, §12.1054, allows employees of an open-enrollment charter school rated acceptable or higher for at least two of the preceding three school years to serve as members of the governing body of the school if the employees do not constitute a quorum of the governing body. The VPS charter school board is made up of five members and the charter holder board is made up of three members, so the board membership of the superintendent and the facilities and operations manager are allowed. Due to the exception to nepotism rules and lack of a quorum the two VPS employees have on the governing boards, this concern was not substantiated.

Summary and Analysis of Charter School's Response:

The charter school requested that the agency remove this section from the report. TEA auditors found that the charter school did not violate nepotism prohibitions as the school is exempted from them under TEC, §12.1055. TEA has retained that finding as a part of this report.

Accounting and Budgeting

Concern	The VPS is not in compliance with state and federal regulations regarding its accounting functions and budget review.
Statutory, Regulatory, and/or Contractual Authority	34 CFR, §80.20 (see Appendix M). Module 1.5.4.1 of the *FASRG*, Budgets and Planning (see Appendix N). Module 2.3 of the *FASRG*.
Finding	The charter school failed to comply with state and federal regulations regarding its

accounting functions and budgetary review.

Investigative Summary	The auditors requested documentation that would allow them to compare the charter school's budgeted amounts and actual expenditures for fiscal year 2011. The VPS did not have this information available, and the superintendent stated that she had not updated her budget or reviewed the budget-to-actual expenditures since October 2010.

The auditors also noted that the VPS keeps all of its accounting records tied to one fund until the contracted accountant designates the appropriate funds for all transactions. This happens with unknown frequency. During the site visit, the auditors requested that the accountant provide detailed account information because the individual fund statements had not been prepared. The general ledger, with transactions listed by fund, was not provided until March 23, 2011. The VPS did not demonstrate that it complied with the standards for financial management systems promulgated in 34 CFR, §80.20(b)(2), and Module 1.5.4.1 of the *FASRG*. Specifically, the auditors noted that VPS accounting records did not adequately comply with the *FASRG* and/or did not provide sufficient or adequate accounting data for the transactions recorded in the general ledger. Module 2.3 of the *FASRG* states, "Budget preparation is not a one-time exercise to determine how a school district will allocate funds. Rather, school district budget preparation is part of a continuous cycle of planning and evaluation to achieve district goals." Module 1.5.4.1, Item 1, of the *FASRG* recommends that a comparison of the budget and actual expenditures be made with reasonable (monthly) frequency and in a timely manner. The charter school's lack of budgetary oversight indicated by its failure to compare budget and actual expenditures shows that the charter school fails to comply with state and federal regulations regarding its accounting functions and budgetary review.

Summary and Analysis of Charter School's Response:

The VPS disagreed with this finding. It asserted that it does review and update its budget and compare budgeted expenditures to actual expenditures on a regular, consistent basis. A footnote in the VPS response stated that Ms. Cluff denies having said during the on-site investigation that she had not reviewed the charter school's budget since October 2010.

During the on-site visit, the charter school was not able to provide documentation that it actively reviews the budget. In its response to the preliminary report, the school did not provide any additional documentation indicating that it reviews the budget monthly. The finding stands.

Procurement of the Administration Building

Concern	The VPS has not followed the proper procurement laws when obtaining contracts greater than $25,000 for construction and/or renovations of school facilities.
Statutory, Regulatory, and/or Contractual	Texas Local Government Code, Chapter 271, Subchapter B (see Appendix O).

Authority

Finding — It appears that the charter school failed to follow Texas Local Government Code, Chapter 271, Subchapter B, when procuring a contractor for constructing the current administration building and for other renovation work.

Investigative Summary — In the summer of 2008, the charter school contracted with CoMark Building Systems Inc. to construct a prefabricated administration building for $448,654. The auditors requested supporting documentation that showed that VPS complied with competitive procurement laws. In a letter dated May 26, 2011, the superintendent stated that the school did not obtain bids for the building project because the company was on the state's list of approved vendors of temporary buildings. However, the charter school was still obligated to comply with procurement laws, and so its failure to obtain bids was a violation of Texas Local Government Code, Chapter 271, Subchapter B.

Additionally, the VPS had electrical, site prep, and foundation work done on the administration building during the spring of 2009. The VPS did not obtain bids for this work even though the cost exceeded the minimum threshold amount that requires competitive procurement. This was also a violation of Texas Local Government Code, Chapter 271, Subchapter B.

Summary and Analysis of Charter School's Response:

In its initial response to the preliminary report, the VPS asserted that Texas Local Government Code, Chapter 271, is not applicable and that the school is instead subject to the provisions of Texas Government Code, Chapter 2254. The charter school further asserted that under Texas Government Code, Chapter 2254, the school was allowed to obtain services for construction of the administration building without using a competitive bidding process because the contract involved procurement of the professional services of an engineer or architect rather than the acquisition of property. The school stated that it did in fact meet with other independent contractors before selecting CoMark and listed six reasons why the school selected CoMark over the other contractors. In a later response to the preliminary report, the VPS argued that competitive procurement laws did not apply to its procurement of a builder because Varnett Academy Inc. was the ultimate purchaser. The VPS also stated that it thought it had complied with Texas Local Government Code, Chapter 271, because CoMark represented to the school that CoMark was part of the state-approved purchasing cooperative. However, that representation was not correct.

The VPS did not address the other construction projects related to the electrical, site prep, and foundation work for the administration building other than to state that the ultimate purchaser of the building on which the work was done was Varnett Academy Inc. If true, the transactions surrounding the purchase of the building constitute a loan from the VPS to a for-profit related-party entity (Varnett Academy Inc.), which violates Article III, §52, of the Texas Constitution. The finding stands.

TEA AUDITOR FINDINGS—AMERICAN RECOVERY AND REINVESTMENT ACT

Concern — The VPS is not in compliance with the regulations for administering the American Recovery and Reinvestment Act of 2009 (ARRA) grant funds.

Statutory, Regulatory, and/or Contractual Authority	34 CFR, §80.20 (see Appendix M).
Finding	The VPS failed to comply with 34 CFR, §80.20, in accounting for its ARRA funds.
Investigative Summary	A review of the accounting records provided by the VPS showed that the charter school uses QuickBooks as its financial accounting system. A review of the general ledger revealed that a budget is not incorporated into the accounting system. This situation restricts the users of the financial accounting system from conducting thorough reviews that compare actual expenditures to budgeted amounts. This is a violation of 34 CFR, §80.20(b)(4), which states that the actual expenditures must be compared with budgeted amounts for each grant or subgrant.

Summary and Analysis of Charter School's Response:

As a correction, the regulation cited for this finding should be 34 CFR, §74.21(b)(4), instead of 34 CFR, §80.20(b)(4). Title 34 CFR, §74.21(b)(4), states, "Recipients' financial management systems shall provide for the following: . . . (4) Comparison of outlays with budget amounts for each award. Whenever appropriate, financial information should be related to performance and unit cost data." This citation of 34 CFR, §74.21(b)(4), replaces the citation of 34 CFR, §80.20(b)(4), in the preliminary report.

The VPS disagreed that the budget must be incorporated into the general ledger. The charter school asserted that the budget only has to be *compared* to actual expenditures in the general ledger, as stated in 34 CFR, §80.20(b)(4), and that the school does conduct routine comparisons. The charter school further asserted that the TEA cannot impose additional accounting requirements on the VPS beyond federal law.

Regardless of which federal regulation is cited, the United States Department of Education has repeatedly emphasized that a nonprofit charter school functions as a governmental unit and is therefore subject to rules applicable to governmental units when it receives federal grant funds for educational purposes. The only exception (inapplicable here) occurs when a charter school (acting as either a nonprofit or an LEA) receives a start-up grant under the federal Charter Schools Program (see November 16, 2012, and May 9, 2013, letters from Thomas P. Skelly to Cory Green). The finding stands. The charter school is not required to take any further action related to this finding.

TEA ACTION SPECIFIED IN PRELIMINARY REPORT

1. TEA will take appropriate administrative actions regarding possible violations of state and federal rules and regulations resulting from the failure of the charter holder board to uphold its fiduciary responsibilities in safeguarding the assets of the school.
2. The Division of Financial Audits [now the Division of Financial Compliance] will send a copy of the final report to the appropriate federal program offices for any action deemed necessary to recover questioned costs.

REQUIRED ACTIONS SPECIFIED IN PRELIMINARY REPORT

1. The charter school must conduct a comprehensive review of internal control policies and procedures and make the necessary modifications to address the findings contained in this report.
2. The charter school should ensure that financial records and documentation are consistent with *FASRG* requirements.
3. The charter school should obtain a credit card in its name or use purchase orders and checks to obtain school-related supplies and materials.
4. The charter school should provide Title I, Part A, training for planning team members, develop a comprehensive set of materials for the planning team to use during the annual review of their schoolwide plans, and conduct a technical assistance workshop for existing schoolwide schools on required plan components and timeframes for plan review and revision.
5. The charter school should ensure that each Title I, Part A, schoolwide campus develops a schoolwide plan that incorporates the school's vision and mission statements, a concise version of the school profile, and a summary of the needs assessment, and also addresses how the 10 components will be addressed through the established goals and the implementation of research-based strategies.

Summary of Charter School's Response Regarding Required Actions Specified in Preliminary Report:

The charter school stated that it is taking the following actions:

1. **The VPS is working on a review of its internal control policies and is conducting additional training for its board members.**
2. **The VPS intends to ensure that its financial records and documentation comply with the *FASRG* and welcomes any guidance from TEA.**
3. **The VPS has applied and been approved for a credit card in the school's name.**
4. **The VPS intends to provide training related to Title I and welcomes TEA's guidance**
5. **The VPS intends to develop and incorporate the 10 components for a schoolwide program in its plans and welcomes TEA's guidance.**

FINAL DETERMINATION AND PLANNED TEA ACTIONS

The findings in this report demonstrate a failure by the corporate and charter school boards and school officials to provide adequate oversight of the operations and assets of the Varnett Public School, a state and federally funded charter school, in violation of the standards set forth in Texas Business Organizations Code, §22.221. The issues identified in this report result directly from this lack of oversight by the charter school's board members and officials. **The charter school board allowed school officials to enrich themselves through related-party contracts and the improper use of school funds, and it failed to ensure that the school's financial and accounting system and financial practices comply with state and federal law and regulation.**

TEA Actions

1. **TEA will take appropriate administrative actions regarding possible violations of state and federal laws and regulations resulting from the failure of the charter holder board to uphold its fiduciary responsibilities in safeguarding the assets of the school.**
2. **The Division of Financial Compliance will send a copy of the final report to the appropriate federal program offices for any action deemed necessary to recover questioned costs.**

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February 1, 2013

By E-Mail: Michael.Rigby@tea.state.tx.us
<u>and by U.S. Mail, CM/RR No. 7012 1010 0002 0589 8417</u>

Sonya Etheridge
Director, Division of Financial Audits
Michael Rigby
Associate General Counsel
Texas Education Agency
William B. Travis Building
1701 N. Congress Avenue
Austin, Texas, 78701

Re: Preliminary Investigative Report, The Varnett Public School #101-814

Dear Ms. Etheridge and Mr. Rigby,

Please accept this letter as The Varnett Public School's Response to the Texas Education Agency's ("TEA") Preliminary Investigative Report ("Report") dated June 1, 2012. The Varnett Public School appreciates the opportunity to respond to the allegations contained in the Report. It also welcomes the opportunity to discuss the differences of opinion that are outlined below.

On behalf of our client, we believe the majority of the allegations in the Report are legally and factually incorrect. We provide the detailed basis for our belief in the analysis that follows. A significant basis for this belief is the fact that a number of the issues raised in the Report have been continuously and frequently disclosed by The Varnett Public School to the TEA and its independent, outside auditor over the past two decades. We vigorously dispute any suggestion that our client or its principals have ever acted with unlawful intent. Having said that, we acknowledge where innocent mistakes have been made by our client and recognize the possibility of improving some of our client's business practices.

Though we have an obligation to note our disputes with the TEA's proposed findings, we want to be clear that our client is willing to perform any reasonable and necessary acts to ensure that it provides the best education to its students while complying with its obligations under the applicable laws. The Varnett Public School's vision is to create an environment in which every student receives a quality education in a safe environment, and assure every student access to a

learning environment that encourages them to be in school with other students learning to the best of their ability. All objective markers indicate that our client has realized that vision.

After the TEA has had a sufficient opportunity to review The Varnett Public School's Response, our client would welcome the opportunity to meet with representatives of the TEA to discuss all available opportunities for The Varnett Public School to improve its services. The Varnett Public School sincerely hopes that the substance of its Response, its history, its performance, and its willingness to work with the TEA will resolve this investigation satisfactorily to all involved.

INTRODUCTION AND BACKGROUND

In 1984, M. Annette Cluff, Ed.D and Alsie Cluff, Jr. established The Varnett Public School in Houston, Texas with their own money in order to create a school that would meet the educational and cultural needs of their own son, Alsie Cluff, III. Through the effort and leadership of Mr. and Mrs. Cluff over the past thirty years, The Varnett Public School has grown from a single campus with a population of ten students to three campuses with a population of 1,800 students.

From 1984 through 1998, The Varnett Public School operated as a private school. In 1998, the TEA granted The Varnett Public School an open-enrollment charter. During its time period as an open-enrollment charter school, The Varnett Public School has achieved tremendous success.

Besides quadrupling its student population and tripling its campuses since 1998, The Varnett Public School has consistently achieved academic and fiscal recognition. For example, in the 2010 school year (the last school year before the TEA audit), The Varnett Public School was recognized as an Exemplary School District on the State of Texas' Academic Excellence Indicator Scale ("AEIS"); two of its three campuses were recognized as Exemplary Schools on AEIS; the third campus was recognized as a Recognized School on AEIS; and its East campus was recognized as a Texas Blue Ribbon School in 2009 and, after being nominated by the State of Texas, was recognized as National Blue Ribbon School in 2010. The Exemplary rating is the highest ranking possible.

Likewise, The Varnett Public School and each of its campuses satisfied the federal government's No Child Left Behind Act's Annual Yearly Progress results in 2012; the State of Texas did not. And, The Varnett Public School has satisfied these results in five of the last six years.

Turning to its financial status, The Varnett Public School received a rating of Superior Achievement on the Financial Integrity Rating System of Texas ("FIRST") in 2010-2011. For

2009-2010 and 2008-2009, The Varnett Public School received a rating of Standard Achievement on FIRST. And, in 2007-2008, The Varnett Public School received a rating of Meets Standard on FIRST. For each of the respective years, The Varnett Public School received the highest ranking possible.

Furthermore, The Varnett Public School has never been cited for any material weaknesses or deficiencies in any of its annual Audit Reports from 1998 through 2011. During this same time period, The Varnett Public School's expenses came in under budget every year except one, and The Varnett Public School was able to accumulate over $16 million in net assets.

The Varnett Public School's success is magnified by the fact that The Varnett Public School's student population has been overwhelmingly minority and overwhelmingly economically disadvantaged with a significant at-risk and limited English-speaking population. For example, in the 2010-2011 school year, over 99 percent of The Varnett Public School's student population was classified as belonging to a minority, 97 percent were classified as being economically disadvantaged, 28 percent had limited English proficiency, and over 39 percent were classified as at-risk students. Simply put, The Varnett Public School has brought academic excellence to a vulnerable and disadvantaged population.

Simply put, The Varnett Public School has achieved tremendous results in the face of difficult circumstances. The one constant for The Varnett Public School over the past thirty years has been the Cluff family. And, while The Varnett Public School is certainly aware that Mr. and Mrs. Cluff's involvement with The Varnett Public School may create a false, yet facial appearance of impropriety, The Varnett Public School contends that Mr. and Mrs. Cluff have given far greater to The Varnett Public School and its students than they have ever received. Furthermore, The Varnett Public School asserts that Mr. and Mrs. Cluff have not engaged in any improper activities. It is against this backdrop that The Varnett Public School responds to the TEA's Report.

I. FEDERAL PROGRAMS

In the Report, the TEA identified three areas in which it believes that The Varnett Public School failed to satisfy distinct federal requirements. See Report, "Federal Programs" at 2-6. First, the TEA alleges that The Varnett Public School did not comply with federal statutes and regulations regarding the implementation of a comprehensive needs assessment and a comprehensive plan in 2009, 2010, and 2011. Second, the TEA asserts that The Varnett Public School did not follow federal time-and-effort rules in 2009, 2010, and 2011. Lastly, the TEA argues that The Varnett Public School improperly used federal funds for landscaping services, janitorial services, and utilities. The Varnett Public School disagrees with each of these three allegations. The Varnett Public School will address each of the allegations separately below.

A. The Varnett Public School Complied with All Applicable Federal Requirements Regarding its Comprehensive Needs Assessment and Comprehensive Plan in 2009, 2010, and 2011

As its first finding relating to federal programs, the TEA contends that The Varnett Public School did not comply with 20 U.S.C. § 6314 because The Varnett Public School did not (a) conduct a comprehensive needs assessment in 2009, 2010, and 2011, and (b) develop a full schoolwide improvement plan in 2009, 2010, and 2011. The TEA's findings are legally and factually incorrect.

i. The Varnett Public School Was Not Required to Conduct a Comprehensive Needs Assessment or Comprehensive Plan in 2009, 2010, and 2011.

Section 6314(b) of Title 20 of the U.S. Code provides that a local education agency that operates a schoolwide program in which federal, state, and local funds are consolidated must conduct a comprehensive needs assessment that is based on information which includes the achievement of children in relation to the State academic content standards and the State student academic achievement standards. 20 U.S.C. § 6314(b)(1)(A). The comprehensive needs assessment must: (a) be based on academic achievement information about all students to help the local education agency understand where teaching and learning need to be improved and identify the needs of students who are not yet achieving the State's academic standards, and (b) assess the local education agency's needs based on the other components for a schoolwide program. 34 C.F.R. § 200.26.

Importantly for purposes of this Response, the comprehensive needs assessment must only be performed once—when the local education agency originally implements or amends its consolidated schoolwide program in response to the provisions enacted by the No Child Left Behind Act of 2001. 34 C.F.R. §§ 200.26-.27. After the comprehensive needs assessment is conducted, a local education agency must use it to formulate a comprehensive plan under § 6314(b)(2). In its comprehensive plan, a local education agency must describe how it will implement the components set forth in § 6314(b) and 34 C.F.R. § 200.27 and identify which resources will be used to implement those components. 20 U.S.C. § 6314(b)(2); 34 C.F.R. § 200.27.

A local education agency, although required to evaluate its comprehensive plan annually, is only required to revise its comprehensive plan as it deems necessary. 34 C.F.R. § 200.26. The comprehensive plan, as originally drafted and revised, remains in effect for as long as the local education agency operates a consolidated schoolwide program. 34 C.F.R. § 200.27.

Ultimately, the comprehensive plan must be drafted in a format that is understandable, uniform, and in a language that parents can understand. 20 U.S.C. § 6314(b)(2)(B). And, the TEA "shall require only descriptions, information, assurances, and other material that are absolutely necessary for the consideration of the local educational agency plan or application." 20 U.S.C. § 7845.

Accordingly, The Varnett Public School was only required to conduct a single comprehensive needs assessment and to amend its pre-No-Child-Left-Behind-Act comprehensive plan once. It did so originally in November 2000, and has revised its original assessment and plan annually from 2003 through the present. The Varnett Public School timely and properly performed a comprehensive needs assessment and timely and properly amended its comprehensive plan after the passage of the No Child Left Behind Act of 2001.

ii. The Varnett Public School Did Implement A Satisfactory Comprehensive Needs Assessment and Comprehensive Plan in 2009, 2010, and 2011.

In November 2000, The Varnett Public School first conducted a comprehensive needs assessment and implemented its comprehensive plan. The original comprehensive needs assessment and comprehensive plan pre-dated the enactment of the No Child Left Behind Act of 2001 and covered the years 2000-2003. The original comprehensive plan set forth a series of goals with corresponding measurable objectives.

In addition, the original comprehensive plan identified a series of initiatives designed by The Varnett Public School to help it accomplish its goals. The initiatives identified which persons were responsible for satisfying the initiative, the resources to be used to satisfy the initiative, the timelines for the initiative, how the success of the initiative would be evaluated, and the status of the initiative. In addition, the original comprehensive plan was based on a comprehensive needs assessment conducted by the faculty, staff, and parents of The Varnett Public School.

After the implementation of The Varnett Public School's original comprehensive needs assessment and comprehensive plan, The Varnett Public School voluntarily decided to update its comprehensive plan regularly to provide the best education and services to its students. The Varnett Public School has updated its comprehensive plan annually on a district-wide and individual campus basis. In updating its comprehensive plan each time, The Varnett Public School did conduct a comprehensive needs assessment in which it reviewed the AEIS ratings, student surveys, parent surveys, faculty surveys, discipline reports, and other various documents.

Through these materials, The Varnett Public School was able to understand the subjects and skills that needed improvement and to identify the specific needs of students who were not

yet achieving the State of Texas' academic standards. Moreover, the comprehensive plan always set forth the goals and objectives to be obtained, identified the persons responsible for the goals and objectives, identified the timelines for the goals and objectives, identified the resources to be used to accomplish the goals and objectives, set out how to evaluate performance periodically, and set out how to document accomplishment of the goals and objectives.

Significantly, each update to the comprehensive plan described how The Vamett Public School would carry out each component and identifies the resources to be used in a uniform and understandable format that was designed to be understood by parents. This analysis was set forth in the District Goal, Objective, Action Implementation, and Resource Allocation sections within the District and Campus Improvement Plans. In fact, each of the Action Implementation items was direetly correlated to one or more of the applicable components. A review of these sections demonstrates that The Varnett Public School considered every component set forth in § 6314 and 34 C.F.R. § 200.27 and considered the elcments necessary for a comprehensive needs assessment. Accordingly, The Varnett Public School did satisfy all applicable requirements goveming the contents of its comprehensive needs assessments and comprehensive plans.

iii. The TEA Has Already Determined that The Varnett Public School Has Adequately Conducted a Comprehensive Needs Assessment and Comprehensive Plan in 2009, 2010, and 2011.

The No Child Left Behind Act of 2001 provides that a local education agency, such as The Varnett Public School, may receive federal funds only if the State educational agency, such as the TEA, has received and approved the local education agency's comprehensive plan. 20 U.S.C. 6312(a) ("A local educational agency may receive a subgrant under this part for any fiscal year only if such agency has on file with the State educational agency a plan, approved by the State educational agency, . . .). The Varnett Public School provided the TEA with its District and Campus Improvement Plans for each of the years in question. In turn, the TEA administered approximately $6.5 million in federal funds to Thc Varnett Public School over the years in question. In doing so, thc TEA acccpted and approved the District and Campus Improvement Plans at issue.

Moreover, The Varnett Public School has provided all of its District and Campus Improvcment Plans to the TEA. The TEA never once objected to any of the plans or raised any issue in connection with the plans. Instead, the TEA has approved each of the plans and consistently administered millions of dollars in federal funds to The Varnett Public School year after year. Accordingly, the TEA should not take a completely contrary position now.

Furthermore, the TEA's approval of Thc Vamett Public School's plan is supported by the opinion of an independent auditor. In 2010, The Varnett Public School rctained the services of Gomez & Company to determine if The Varnett Public School satisfied the State of Texas'

Compensatory Education Requirements. See Compensatory Education Report (March 8, 2010). As part of the independent evaluation, Gomez & Company determined that The Varnett Public School's District and Campus Improvement Plans contained all the required components. Id. at 8.

In sum, the No Child Left Behind Act of 2001 left considerable discretion to local education agencies to determine the format to be used in conducting comprehensive needs assessments and developing comprehensive plans. Ultimately, the No Child Left Behind Act of 2001 places a distinct emphasis on the substance, not the form, of the comprehensive needs assessment and comprehensive plan. The substance of The Varnett Public School's District and Campus Improvement Plans demonstrate that The Varnett Public School satisfied any applicable comprehensive-needs-assessment and comprehensive-plan requirements. The TEA and an independent auditor have each confirmed this fact.

B. The Varnett Public School Was Not Required to Maintain Time-and-Effort Documentation in 2009, 2010, and 2011

As its second finding relating to federal programs, the TEA has concluded that The Varnett Public School failed to comply with the U.S. Office of Management and Budget's ("OMB") Circular A-122, Attachment B(8)(m) because The Varnett Public School did not provide TEA auditors with signed semiannual certifications of activity from employees who worked on federal awards or with signed monthly personnel activity reports for employees whose salary or wages were funded by more than one federal award or nonfederal source. See Report, "Federal Programs" at 4-5. We respectfully disagree with this conclusion for multiple reasons.

Initially, it must be noted the OMB Circular A-122 does not apply to The Varnett Public School. Instead, as set forth by the U.S. Department of Education and as recognized by the TEA in its own internal document, "Guidance for the Implementation of Title I, Part A: Improving Basic Programs Operated by Local Education Agencies," OMB Circular A-87, Attachment B(8)(h)(3) is the applicable rule. See U.S. Office of Management and Budget, Circular A-87, Attachment B(8)(h)(3); "Guidance for the Implementation of Title I, Part A: Improving Basic Programs Operated by Local Education Agencies," Texas Education Agency at 45-46 (Feb. 1, 2010).

Generally, Circular A-87 requires one of two certifications for entities that use federal funds to pay employee salaries: (a) if an employee only works on a single federal program, the employee must provide periodic certifications supporting the fact the employee only worked on that federal program; or (b) if an employee works on multiple federal programs, the employee must prepare personnel activity reports to support the distribution of his salary among the various federal programs. See U.S. Office of Management and Budget, Circular A-87, Attachment

B(8)(h)(3); "Guidance for the Implementation of Title I, Part A: Improving Basic Programs Operated by Local Education Agencies," Texas Education Agency at 45-46 (Feb. 1, 2010).

However, the general rules set forth in Circular A-87 as applied to employees in local education agencies vary depending on different circumstances. See "Guidance for the Implementation of Title I, Part A: Improving Basic Programs Operated by Local Education Agencies," Texas Education Agency pp. 45-46 (Feb. 1, 2010). For local education agencies that operate a schoolwide program in which federal, state, and local funds are consolidated under 20 U.S.C. § 6314, such as The Varnett Public School, an employee who is paid with funds from that consolidated pool "is not required to file a semi-annual certification. Because Federal funds are consolidated with State and local funds in a single consolidated schoolwide pool, there is no distinction between staff paid with Federal funds and staff paid with State or local funds." Id. at 45. Accordingly, because The Varnett Public School operates a schoolwide program in which all funds are consolidated, it does not have to comply with the general requirements set forth in Circular A-87.

C. The Varnett Public School Was Permitted to Use Federal Funds for Landscaping Services, Janitorial Services, and Utilities in 2010 and 2011

As its third finding relating to federal programs, the TEA has determined that The Varnett Public School inappropriately used Title I, Part A federal funds to pay for landscaping services, janitorial services, and utilities in 2010 and 2011. See Report, "Federal Programs" at 5-6. The TEA, relying on the same internal document that it misinterpreted in regards to the federal certification finding above, argues that these three services are "non-educational activities" that may not be funded with Title I, Part A funds. Id. We respectfully disagree with this conclusion.

The general rule for local education agencies is that Title I, Part A federal funds may only be used to address the local education agencies' educational needs and may not be used to address non-educational activities, such as landscaping services, janitorial services, or utilities. "Guidance for the Implementation of Title I, Part A: Improving Basic Programs Operated by Local Education Agencies," Texas Education Agency at 40-41. However, this general rule does not apply to local education agencies, such as The Varnett Public School, that consolidate federal, state, and local funds. Id.

As indicated in the Preliminary Investigative Report, Title I, Part A federal funds lose their federal identity when they are consolidated by a local education agency with its other federal, state, and local funds. Id. In these circumstances, a local education agency may use its consolidated Title I, Part A federal funds on any activity, provided that the funds "supplement," not "supplant," the local education agencies' state funds. Id. Essentially, a local education

agency must ensure that it receives all the state funds it would need to operate in the absence of federal funds. Id. This rule exists to ensure that the level of state funds available to a local education agency remain at least constant. Texas Education Agency, Program Appendices for No Child Left Behind, Appendix 8: Supplement, Not Supplant (May 1, 2006).

Simply put, local education agencies using consolidated funds in a schoolwide program are "not required to meet most statutory or regulatory requirements of the [Title I, Part A] program applicable at the school level, but must meet the intent and purpose of that [Title I, Part A] program to ensure that the needs of the intended beneficiaries are met." "Guidance for the Implementation of Title I, Part A: Improving Basic Programs Operated hy Local Education Agencies," Texas Education Agency at 43; see also 69 Fed. Reg. 40360-64 (July 2, 2004). A local education agency "must be able to demonstrate that its schoolwide program contains sufficient resources and activities to reasonably address the intent of the intended [Title I, Part A] programs, particularly as they relate to the lowest-performing students." "Guidance for the Implementation of Title I, Part A: Improving Basic Programs Operated by Local Education Agencies," Texas Education Agency at 43; see also 69 Fed. Reg. 40360-64. Accordingly, The Varnett Public School may use Title I, Part A federal funds on non-educational activities, so long as The Varnett Public School can demonstrate that it satisfied the "intent and purpose" of the Title I, Part A program.

The TEA has determined that the intent and purpose of Title I, Part A federal funds is "to provide opportunities for children served to acquire the knowledge and skills contained in the state content standards and to meet the state performance standards." Texas Education Agency, Program Appendices, Appendix 8: Supplement, Not Supplant at 2. Ultimately, the effectiveness of any Title I, Part A program is "measured by student performance." Id. at 3. Thus, The Varnett Public School can satisfy its burden that the intent and purposes of its Title I, Part A federal funds have been met by demonstrating that its students have performed academically well.

In terms of student performance, The Varnett Public School received a district-wide AEIS rating of Recognized in 2008, Recognized in 2009, and Exemplary in 2010. The Varnett Public School's Southwest Campus received a campus AEIS rating of Recognized in 2008, Recognized in 2009, and Exemplary in 2010. The Varnett Public School's Northeast Campus received a campus AEIS rating of Academically Acceptable in 2008, Recognized in 2009, and Recognized in 2010. The Varnett Public School's East Campus received a campus AEIS rating of Academically Acceptable in 2008, Exemplary in 2009, and Exemplary in 2010. Likewise, The Varnett Public School's East Campus was recognized as a Texas Blue Ribbon School in 2009 and, after being nominated by the State of Texas, was recognized as a National Blue Ribbon School in 2010.

The Varnett Public School, on both a district-wide and on an individual campus basis, has produced these results all while providing its services to a 99+% minority student-population, a 97+% economically disadvantaged student-population, a 28+% limited English proficiency student-population, and a 39+% at-risk student population. These performance-based results demonstrate that The Varnett Public School has satisfied the intent and purpose behind its Title I, Part A federal funds.

In addition, The Varnett Public School has not supplanted its receipt of state funds with its Title I, Part A federal funds. In fact, the amount of state funds received by The Varnett Public School has increased each fiscal year from 2007 through 2011. In 2007, The Varnett Public School received $9,033,654 in state funds. In 2008, The Varnett Public School received $10,551,176 in state funds. In 2009, The Varnett Public School received $10,843,656 in state funds. In 2010, The Varnett Public School received $11,638,400 in state funds. In 2011, The Varnett Public School received $13,571,377 in state funds. Furthermore, in three of these five fiscal years (2008, 2009, and 2011), The Varnett Public School's total expenses were less than the amount of state funds received. And, in 2007 and 2010, The Varnett Public School's total expenses only exceeded the amount of state funds received by $158,272 (10% of its total federal funding) and $412,768 (12% of its total federal funding). The Varnett Public School has not supplanted state funds with federal funds. Instead, The Varnett Public School has used its Title I, Part A federal funding to supplement its state funding.

II. Conflict of Interest in a Sale-and-Leaseback Transaction

In the Report, the TEA identified a number of other areas of concern separate-and-apart from its federal findings. The first non-federal finding made by the TEA alleges that The Varnett Public School breached its fiduciary duties to its students by entering into a commercial transaction for the sale and lease of an administration building at 11211 Clematis Lane, Houston, Texas 77035. Report, "Conflict of Interest in a Sale-and-Leaseback Transaction" at 6-8. Similarly, the TEA contends that Mr. and Mrs. Cluff each improperly used their position to influence the transactions.[1] Id. The Varnett Public School disagrees with the TEA's findings, and asserts that the findings are legally and factually incorrect.

In the early 1990s, the Varnett Academy, Inc. purchased the first of three separate parcels of land in southwest Houston, Texas.[2] Throughout the remainder of the decade, the Varnett Academy, Inc. purchased the other two parcels of property. Today, these three parcels of land now encompass one contiguous tract of land that serve as The Varnett Public School's Southwest

[1] Mrs. Cluff serves as the Superintendent of The Varnett Public School; Mr. Cluff serves as the Facilities and Operations Manager for The Varnett Public School.

[2] Between 1984 and 1998, The Varnett Public School operated as the Varnett Academy, Inc. (a private elementary school).

Campus, Administration Building, PreKindergarten Learning Center, and Child Nutrition Breakfast/Lunch Program Building.

Each of the three parcels was purchased by the Varnett Academy, Inc. before The Varnett Public School was granted its charter by the State of Texas. The TEA has been aware of the relationship between the Varnett Academy, Inc. and The Varnett Public School since The Varnett Public School's original charter application in 1998. See Application for Approval for an Open-Enrollment Charters, Appendix B (Jan. 9, 1998). And, the transactions at issue were specifically made known to the TEA by The Varnett Public School through the 2009 and 2010 Audit Reports. See The Varnett Schools, Inc. d/b/a The Varnett Public School, 2009 Audit Report at p. 9 (Jan. 12, 2010); The Varnett Schools, Inc. d/b/a The Varnett Public School, 2010 Audit Report at p. 9 (Jan. 13, 2011).

In 2008, The Varnett Public School decided to obtain a modular building from Comark Building Systems, Inc. to serve as its Administration Building. See The Varnett Charter School Board of Directors, Fact Sheet (April 10, 2008). As a result, The Varnett Public School and Comark Building Systems, Inc. executed a written contract. See Contract Between Varnett Public School and Comark Building Systems, Inc. (May 30, 2008). Under the contract, The Varnett Public School would pay Comark Building Systems, Inc. \$448,654.00, and Comark Building Systems, Inc. would construct the modular building at 11211 Clematis Lane, Houston, Texas 77035 and transfer ownership of the modular building to The Varnett Public School. Id.

After the modular building was constructed, The Varnett Public School's certified public accountant and attorney Frederick E. Coveler, CPA of Coveler & Associates, P.C. advised The Varnett Public School that the Administration Building was a structure permanently attached to the land. Mr. Coveler further advised The Varnett Public School that, because the modular building was permanently attached to the land, there were a number of legal and accounting issues surrounding The Varnett Public School's ownership of the Administration Building. Mr. Coveler, therefore, advised The Varnett Public School that it should sell the Administration Building to the Varnett Academy, Inc. (the land owner) at cost.

Based on the advice of its legal and financial advisor, The Varnett Public School sold the Administration Building to the Varnett Academy, Inc. See Contract Between The Varnett Public School and the Varnett Academy, Inc. (July 2009); The Varnett Public School, Board Resolution (July 9, 2009). The sales contract required The Varnett Public School to transfer title of the Administration Building to the Varnett Academy, Inc. in exchange for a payment of \$426,221.30 and the assumption of the remaining \$22,432.70 owed by The Varnett Public School to Comark Building Systems, Inc. (\$426,221.30 + \$22,432.70 = \$448,654.00). Id.

In addition to the purchase price for the modular building, The Varnett Public School had expended \$167,803.00 for various improvements (electrical services, foundation, detention pond,

gutters, and sound system) undertaken in connection with the construction of the Administration Building. See The Varnett Public School, Board Resolution (Feb. 9, 2010). This time, Mr. Coveler and Benjamin P. Gomez, CPA of Gomez & Company advised The Varnett Public School that the Varnett Academy, Inc. was responsible for the costs of these improvements. Accordingly, Mr. Coveler and Mr. Gomez advised The Varnett Public School that it should seek reimbursement from the Varnett Academy, Inc. for the costs of these improvements.

In February 2010, The Varnett Public School received full reimbursement for the costs of these improvements from the Varnett Academy, Inc. Id. As a result of the July 2009 sale and February 2010 reimbursement, the Varnett Academy, Inc. became the owner of the Administration Building and had fully reimbursed The Varnett Public School.

Because the Varnett Academy, Inc. now owned the Administration Building, The Varnett Public School was required to lease the Administration Building from the Varnett Academy, Inc. In order to determine the fair market value for the lease of the Administration Building, The Varnett Public School retained G.K. Coleman & Sons to perform an appraisal. G.K. Coleman & Sons performed the appraisal and determined that the fair market value for a monthly lease of the Administration Building was $17,600. See Appraisal Report (July 28, 2009). Accordingly, the Varnett Academy, Inc. and The Varnett Public School entered into a fair-market-value lease agreement based on the appraiser's expert opinion.

Neither Mrs. Cluff, who was not a member of charter school board, nor Mr. Cluff, who was a member of the charter school board, participated in any deliberation or vote related to these transactions. See The Varnett Public School, Board Resolution (July 9, 2009); The Varnett Public School, Board of Directors, Meeting Minutes (July 9, 2009); The Varnett Public School, Board Resolution (Feb. 9, 2010). Moreover, The Varnett Public School has not done anything to hide or to obscure the transactions between it and the Varnett Academy, Inc. In its 2009 Audit Report, The Varnett Public School expressly informed the TEA about the sale and leaseback of the Administration Building. See 2009 Audit Report at p. 9.

The Varnett Public School's decision to sell the Administration Building to the Varnett Academy, Inc. and decision to lease the Administration Building from the Varnett Academy, Inc. was not tainted by any alleged conflict of interest. Rather, every board member and the TEA knew about The Varnett Public School's relationship to the Varnett Academy, Inc. That is why Mr. and Mrs. Cluff did not participate in any deliberation or vote in connection with the Varnett Academy, Inc. This arrangement complied with Texas law and The Varnett Public School's own internal guidelines. The Varnett Public School's decisions, therefore, were free from any conflict of interest or illegality.

Likewise, The Varnett Public School's decision to sell and to lease was in the best interest of its students. The Varnett Public School hired an expert in real-estate appraisal to

determine the fair market value for the lease of the Administration Building. The Varnett Public School used this appraisal to determine the lease payments. This action demonstrates that The Varnett Public School complied with its fiduciary obligations.

Lastly, the TEA's blanket allegation that The Varnett Public School failed to consider any other alternatives is incorrect. Prior to purchasing the modular building from Comark Building Systems, Inc., The Varnett Public School made the decision that the construction of an administration building was in the best interests of the school. Once it was determined that The Varnett Public School could not own the structure, The Varnett Public School was left with 2 options: (1) sell the Administration Building to the Varnett Academy, Inc. and lease the Administration Building for its own use, or (2) abandon the Administration Building, find and purchase a new tract of land somewhere else, and construct a new Administration Building on the new tract of land.

Faced with the certainty of the first option (which ensured that The Varnett Public School was reimbursed fully and ensured that the Administration Building was on the same premises as The Varnett Public School's Southwest Campus, PreKindergarten Learning Center, and Child Nutrition Breakfast/Lunch Program Building) versus the uncertainty of the second option, The Varnett Public School reasonably chose the first option. By doing so, The Varnett Public School fully complied with its fiduciary obligations.[3]

III. TRANSPORTATION CONTRACT

Next, the TEA alleges that The Varnett Public School breached its fiduciary duties to its students by entering into a commercial transaction with the Texas School Bus Company, Inc. See Report, "Transportation Contract" at 8-9. The Texas School Bus Company, Inc. is an entity owned by Mr. and Mrs. Cluff.

The Texas School Bus Company, Inc. was incorporated in 2003 and began its involvement with The Varnett Public School in the 2003-2004 school year. The TEA has been aware of the relationship between the Texas Bus Company and The Varnett Public School since the inception of the relationship. See The Varnett Schools, Inc. d/b/a The Varnett Public School, 2005 Audit Report at p. 11 (Jan. 17, 2006); The Varnett Public Schools, Transportation Operator Information 2003-2004. The TEA contends that Mr. and Mrs. Cluff each improperly used their

3 In January 2012, The Varnett Public School determined that it would be in the best interests of The Varnett Public School if The Varnett Public School, not the Varnett Academy, Inc., owned the Administration Building and the land underneath it. As a result, The Varnett Public School approved the purchase of these assets in May 2012, and is now the owner of the building and the land. This decision was made prior to issuance of the Preliminary Investigative Report and has been reported to the TEA in The Varnett Public School's 2012 Audit Report. See The Varnett Schools, Inc. d/b/a The Varnett Public School, 2012 Audit Report at p. 9 (Jan. 28, 2013).

position to influence the transaction. The Varnett Public School disagrees with the TEA's findings, and asserts that the findings are legally and factually incorrect.

After obtaining its charter, The Varnett Public School originally leased its school buses from Goodman Bus Service, Inc. Goodman Bus Service, Inc. was owned and operated by its namesake Mr. Goodman. After Mr. Goodman died, his daughter decided to cease the entity's daily school transportation services; instead, Goodman Bus Service, Inc. began focusing its services on field trips.

As a result, The Varnett Public School started using the services of the Charter School Bus Company in 2002-2003. A number of parents, students, and staff began complaining to the administration that the conditions of the Charter School Bus Company's school buses were unsatisfactory. For example, the school buses had open holes in the floor, torn seats, no upgrades, and broken windows. The administration investigated the complaints and found that the school buses were dilapidated and unfit for the students.

Ultimately, The Varnett Public School decided not to renew its contract with the Charter School Bus Company. At this time, The Varnett Public School decided that it wanted new school buses with state-of-the-art accommodations that could be personalized for The Varnett Public School. Mrs. Cluff and Transportation Director Kerry Shelton, therefore, began contacting potential new vendors to determine the quality and quantity of available school buses and the lease rates for the school buses. Among the vendors that were contacted were: Badillo Bus Service, J&T Charters, Goodman Bus Service, Inc., and AFC Transportation. These vendors did not have available school buses with air conditioning, with an audio system, with a video system, with a tracking system, and would not personalize the school buses by putting The Varnett Public School's name on the side of the vehicles.

Because The Varnett Public School could not obtain the quality of school buses that it desired from outside vendors, The Varnett Public School determined that it should purchase its own school buses. In doing so, The Varnett Public School could ensure that its students were transported in new, state-of-the-art, clean, working, personalized, air-conditioned school buses. Additionally, The Varnett Public School could ensure that it controlled its own fleet of buses, ensuring that no routes were missed through the acts or omissions of a third-party vendor.

At that time, The Varnett Public School and the Varnett Academy, Inc. were insured by the Hartford Insurance Company. Hartford Insurance Company informed The Varnett Public School that, if The Varnett Public School or the Varnett Academy, Inc. purchased and operated the school buses, Hartford Insurance Company would revoke their policies. The Varnett Public School, therefore, decided to create the Texas School Bus Company to purchase and to operate the school buses.

At the time that the Texas Bus Company purchased the school buses, The Varnett Public School used its market research from other bus companies to determine what would be a fair-market rate for the lease of the school buses. The Varnett Public School provided actual routes to some vendors to obtain a real cost basis for establishing the lease rate. Likewise, The Varnett Public School compared the makes, models, and upgrades of the vendors' school buses with the ones that it would use to help establish a fair-market rate.

The foregoing information and issues were discussed and deliberated by The Varnett Public School's Board of Directors. In weighing the different options and different costs, the Board of Directors determined that it would be in the best interest of The Varnett Public School to lease its school buses from the Texas School Bus Company. Mr. and Mrs. Cluff did not participate in any deliberations or votes in connection with the Texas School Bus Company.

From 2003 through 2012, The Varnett Public School has contracted with the Texas School Bus Company on an annual basis. Each year, The Varnett Public School would renew its contract with the Texas School Bus Company, making adjustments in the contract price to reflect year-to-year costs, inflation, and current rates of other vendors. Mrs. Cluff, Mr. Shelton, and Alsie Cluff, III would contact vendors each year to ascertain a fair-market rate for the upcoming year. Ultimately, the Board of Directors determined that a lease agreement with the Texas School Bus Company was in the best interests of The Varnett Public School each year. Mr. and Mrs. Cluff did not participate in the deliberation or the vote in regards to any of the contracts between The Varnett Public School and the Texas School Bus Company.

Through the operation of the Texas School Bus Company, The Varnett Public School has provided its students with the best services available. All of the school buses used by The Varnett Public School are equipped with a video system, an audio system, air conditioning, and tracking devices. All of the Texas School Bus Company's school buses were purchased as new vehicles. The school buses are maintained in top working order throughout the year. The school buses are dedicated solely to The Varnett Public School's use and are always available. And, the school buses are personalized solely for The Varnett Public School. For the past decade, The Varnett Public School and its students have not had to worry about the condition or the availability of its school buses.

In the Report, the TEA included a table apparently generated from a report issued by the TEA's Division of State Funding.[4] The Varnett Public School, however, does not have access to this report, nor does it have access to the underlying data reflected in the report, such as the make of the school buses, the model of the school buses, and the upgrades to the school buses. The

[4] As a result of the Report, The Varnett Public School reviewed the transportation mileage submitted to the TEA in 2009-2010 and 2010-2011. For 2009-2010, the correct mileage amounts to 95,652 miles. This mileage amounts to a cost per mile of $10.25. For 2010-2011, the correct mileage amounts to 100,746. The Varnett Public School intends to re-submit the correct mileage amounts to the TEA.

Varnett Public School, therefore, cannot comment on the report. If the TEA shares this information with The Varnett Public School, The Varnett Public School would be able to review it and to comment on the relevance of the information in it.

Furthermore, the TEA indicated two instances where The Varnett Public School allegedly paid for transportation unrelated to educational services, namely (a) a tour by teachers of the surrounding neighborhood and (b) a trip by teachers to attend the funeral of a colleague's baby. The Varnett Public School's student-population is overwhelmingly minority and overwhelmingly economically disadvantaged. From a pedagogical standpoint, it is imperative that The Varnett Public School's teachers understand and recognize the hardships that their students encounter every day. Thus, The Varnett Public School takes its teachers on a tour of the surrounding neighborhood each year to see firsthand the conditions in which their students live. The Varnett Public School believes that its teachers will provide the best education to its students only if its teachers have a full appreciation for the students' socio-economic backgrounds. This yearly field trip of the surrounding neighborhood provides teachers with the necessary understanding, recognition, and appreciation for their students and, in turn, allows the teachers to provide an education that is uniquely tailored to the sometimes-unfortunate realities of their students. The Varnett Public School asserts that there is nothing improper about this field trip and stands by its decision to provide this tour.

In addition, The Varnett Public School acknowledges that it paid for its teachers to attend the funeral of a colleague's baby. A school is more than a building. It is a community and a family. The Varnett Public School believes that its teachers should support each other on a daily basis, in good times and especially in rough times. In doing so, The Varnett Public School is able to foster a sense of community and to create a caring environment. This overall sense of unity elevates the performance of its teachers and ensures that its students receive the best education possible. The Varnett Public School contends that there is nothing inappropriate about this field trip and stands by its decision to transport its staff to the funeral of a colleague's baby.

In sum, the Texas School Bus Company's existence began solely for the purpose of providing the best transportation services possible to The Varnett Public School's students. The original contract and the subsequent renewals were each based on first-hand market research. The Texas School Bus Company has provided exemplary service to The Varnett Public School. As a result, The Varnett Public School renewed the contract each year. Mr. and Mrs. Cluff did not participate in any deliberation or vote in connection with the Texas School Bus Company. And, the TEA has been aware of the relationship between the Texas Bus Company and The Varnett Public School from the outset because of the completely transparent disclosures. The Varnett Public School has not breached any fiduciary duty to its students; rather, The Varnett Public School has honored its duties to its students by ensuring that its students' interests are

always placed at the forefront. The Varnett Public School, therefore, requests that the TEA amend its factually and legally incorrect finding.[5]

IV. Annual Governance Reporting Form

As its next finding, the TEA argues that Mr. and Mrs. Cluff violated Texas Penal Code section 37.10 when they each answered "none" to three questions on the 2009-2010 and 2010-2011 Annual Governance Reporting Forms for Open-Enrollment Charter Schools, namely questions 3, 6, and 9. See Report, "Annual Governance Reporting Form" at 10. The Varnett Public School disagrees with the TEA's finding.

The Annual Governance Reporting Forms for Open-Enrollment Charter Schools requests that the signatory provide responses to nine (9) separate inquires. The nine inquiries seek to determine the nine areas of "annual compensation" that the signatory has received from the charter holder, charter school, or management company doing business with the charter holder or charter school.

The Texas Education Code defines "management company" as a "person, other than the charter holder, who provides management services for an open-enrollment charter." Tex. Educ. Code § 12.1012(4). "Management services" means "services related to the management or operation of an open-enrollment charter school." Id. § 12.1012(5). Management services include six (6) specific duties, each of which is directly related to the daily management of the charter and the overall administrative guidance of the charter. Id. The Varnett Public School does not have any relationship with any management company because neither the Varnett Academy, Inc. nor the Texas School Bus Company is a "management company." Thus, as written, the Annual Governance Reporting Forms for Open-Enrollment Charter Schools at issue seek to ascertain only the compensation provided by The Varnett Public School to Mr. and Mrs. Cluff.

Question 3 requested Mr. and Mrs. Cluff to disclose "all compensation received for goods or services under contract, agreement, informal arrangement, or otherwise" from The Varnett Public School. Mr. and Mrs. Cluff each answered "none." These answers are correct.

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[5] In January 2012, The Varnett Public School determined that it would be in the best interests of The Varnett Public School if The Varnett Public School, not the Texas School Bus Company, owned the school buses. See The Varnett Public School Board of Directors Meeting Minutes (Jan. 21, 2012); The Varnett Public School Board of Directors Resolution (Jan. 21, 2012). As a result, The Varnett Public School approved the purchase of these school buses in May 2012. This decision was made prior to issuance of the Preliminary Investigative Report and has been reported to the TEA in The Varnett Public School's 2012 Audit Report. See The Varnett Schools, Inc. d/b/a The Varnett Public School, 2012 Audit Report at p. 9 (Jan. 28, 2013).

Aside from their salaries, Mr. and Mrs. Cluff do not receive any compensation from The Varnett Public School. As the TEA is aware, Mr. and Mrs. Cluff have always disclosed and acknowledged their relationship with the Varnett Academy, Inc. and the Texas School Bus Company. Had the TEA requested the compensation personally received by Mr. and Mrs. Cluff from the Varnett Academy, Inc. or the Texas School Bus Company, Mr. and Mrs. Cluff would have provided the requested information.

Question 6 requested Mr. and Mrs. Cluff to disclose "the fair market value of all personal use of property paid for by the charter holder or the charter school." Mr. and Mrs. Cluff answered "none." These answers are correct.

In January 2010, The Varnett Public School, without the participation of Mr. and Mrs. Cluff, authorized the purchase of two vehicles for use by Mr. and Mrs. Cluff. See The Varnett Public School, Fact Sheet (Jan. 12, 2010); The Varnett Public School, Board of Directors, Meeting Minutes (Jan. 12, 2009). These two vehicles were purchased by The Varnett Public School on January 14, 2010. See Receipt from Russell & Smith Ford (Jan. 14, 2010). Prior to the purchase of these vehicles, Mr. and Mrs. Cluff had used their personal vehicles for school business. In fact, during that time period, Mr. and Mrs. Cluff did not receive any compensation from The Varnett Public School for mileage, maintenance, or depreciation. As a result of these purchases, Mr. and Mrs. Cluff used The Varnett Public School's vehicles for business purposes.

In responding to Question 6, Mr. and Mrs. Cluff did not believe that this question included the use of these specific vehicles because the vehicles are used for "business use," not "personal use." Similarly, Mr. and Mrs. Cluff did not have any reason to withhold or to obscure this information. In its 2010 Audit Report, The Varnett Public School included the receipts for the purchase of the vehicles and a summary of the board minutes that approved the purchase of these two vehicles. Had Mr. and Mrs. Cluff understood or believed the substance of Question 6 to include the use of the specific vehicles at issue, Mr. and Mrs. Cluff would have provided this information as part of the Annual Governance Reporting Forms for Open-Enrollment Charter Schools.

Question 9 requested Mr. and Mrs. Cluff to disclose "all other forms of compensation or remuneration received by the individual from the charter holder or the charter school." Mr. and Mrs. Cluff answered "none." These answers are correct.

Aside from their salaries, Mr. and Mrs. Cluff do not receive any applicable compensation from The Varnett Public School. As the TEA is aware, Mr. and Mrs. Cluff have always disclosed and acknowledged their relationship with the Varnett Academy, Inc. and the Texas School Bus Company. Had the TEA requested the compensation personally received by Mr. and Mrs. Cluff from the Varnett Academy or the Texas Bus Company, Mr. and Mrs. Cluff would have provided the requested information.

In fact, Mrs. Cluff provided the same answers to the TEA as part of her 2011-2012 Annual Governance Reporting Form. See 2011-2012 Annual Governance Reporting Form for M. Annette Cluff. In response, Kathryn Jones of the TEA contacted Mrs. Cluff and requested that she amend her response to Question 9 to include any compensation received from the Texas School Bus Company. Mrs. Cluff, therefore, submitted a Revised 2011-2012 Annual Governance Reporting Form, in which she indicated that she had received $8,000 from tbe Texas School Bus Company. See Revised 2011-2012 Annual Governance Reporting Form. These facts demonstrate that Mrs. Cluff answered the questions on the Annual Governance Reporting Form as she reasonably understood them, and that the TEA could have sought clarification at any previous opportunity.

In sum, Mr. and Mrs. Cluff truthfully answered the pertinent questions in good faith. Mr. and Mrs. Cluff's responses to these questions have been largely identical since their response to the first Annual Governance Reporting Form for Open-Enrollment Charter Schools. Prior to this time, and during the intervening years, the TEA was fully aware of the relationship between The Varnett Public School, the Varnett Academy, Inc., and the Texas School Bus Company by virtue of our client's disclosures. Mr. and Mrs. Cluff have repeatedly demonstrated their willingness to follow directives and guidance provided by the TEA and its agents. If their good faith interpretation of the scope of the question is in error, it is simply a mistake and not a crime.

V. OPEN MEETING ACT

In the next section of the Report, the TEA alleges that The Varnett Public School violated the provisions of the Texas Open Meetings Act by holding board meetings in locations outside the physical structure of the school and via teleconference. See Report, "Open Meeting Act" at 10-11. In addition, the TEA alleges that The Varnett Public School may have violated the provisions of the Texas Open Meetings Act on March 7, 2011, when Mr. and Mrs. Cluff, along with Howard Jefferson, were physically present during the TEA's on-site audit. Id. The Varnett Public School contends that the majority of the TEA's findings are incorrect.

A. The Texas Open Meetings Act Does Not Apply to the 2009-2010 Board Meetings

Section 39.232 of the Texas Education Code provides that a school campus or school district that receives a rating of Exemplary on the TEA's AEIS is exempt from complying with most of the requirements and prohibitions set forth in the Texas Education Code and its regulations.[6] Tex. Educ. Code § 39.232. The Texas Education Code establishes that an open-

[6] For the same reason, The Varnett Public School is exempt from complying with many of the other rules and prohibitions set forth in the Texas Education Code and its regulations.

enrollment charter school is subject to the Texas Open Meetings Act. Id. § 12.1051. Thus, if a school campus or school district is rated as Exemplary, that school campus or school district is exempt from the Texas Open Meetings Act.

The Varnett Public School was rated as Exemplary in 2009-2010. The Varnett Public School, therefore, was exempted from the Texas Open Meetings Act during that time period. Accordingly, the board meetings held on October 10, 2009; June 3, 2010; March 9, 2010; and August 11, 2010 were exempt from thc rcquircments of thc Tcxas Open Mcctings Act.

B. The Texas Open Meetings Act Does Not Prevent Out-of-State Board Meetings

The TEA argucs that five (5) board meetings per se violated the Texas Open Meetings Act because the meetings were held off-campus, namely the (a) November 22, 2008, (b) December 14, 2008, (c) October 10, 2009, (d) June 3, 2010, and (e) January 28, 2011 meetings. The TEA's position is legally flawcd.

The Texas Open Meetings Act only requires that a meeting of a governmental body be "open to the public." Tex. Govt. Code § 551.002. There is no statutory or jurisprudential rule that prevents a governmental body from holding a meeting outside its facilities or outside the State of Texas. See Tex. Atty. Gen. Op. JC-0053 (Tex. A.G. May 26, 1999) ("The Act does not contain any language governing meeting locations, and we have not been able to locate any Texas judicial or attorney general opinion addressing this issuc.") The physical location of the meetings, therefore, only matters so long as the location is accessible to the public.[7] Each of the five meetings at issue was open to the public and, accordingly, did not violate the Open Meetings Act.

C. The Varnett Public School Always Provided Proper Notice of Its Board Meetings

The TEA also indicates that The Varnett Public School failed to provide public notice of these meetings. The TEA's position is incorrect. The Varnett Public School provided proper notice for each of the referenced board meetings. See The Varnett Public School, Notices of Board Meetings. For each of these meetings, and as a general matter, The Varnett Public School permits members of the public to participate at board meetings in-person or through conference call. See The Varnett Public School, Proccdures to Addrcss thc Board of Directors. Thus, The Varnett Public School did not violate any notice provisions.

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7 The Varnett Public School recognizes that, while the locations of these meetings may have been technically and legally "open to the public," holding meetings in these locations is not the best practice; as a result, The Varnett Public School will hold all future board meetings on school grounds.

D. The Varnett Public School Mistakenly Failed to Comply With the Texas Open Meetings Act by Conducting Board Meetings by Telephone Conference

Next, the TEA asserts that eight (8) board meetings conducted by telephone conference call violated the Texas Open Meetings Act. Through this audit process, The Varnett Public School now knows that the Texas Open Meetings Act has strict requirements limiting the use of telephone conference call and other electronic procedures to conduct board meetings. On the identified occasions, The Varnett Public School held its board meetings through telephone conference call to accommodate the schedules and the various conflicts of its members and with the mistaken belief that such an arrangement was permissible.

The Varnett Public School concedes that the use of telephone conference call in these instances was not in full compliance with the Texas Open Meetings Act. However, The Varnett Public School insists that the spirit of the Texas Open Meetings Act was fully honored.

The Texas Open Meetings Act exists to protect the public's interest in knowing the workings of governmental bodies. For each of these meetings, the public was provided timely notice of the meetings and provided an opportunity to attend and to participate in the board meetings in the same manner as the board members. In no form or fashion did The Varnett Public School attempt to obscure its meetings from the public. As a result, while The Varnett Public School may have technically violated the Texas Open Meetings Act, The Varnett Public School did not knowingly violate that statute and did not negate the purpose or goals behind the Act.

E. The Varnett Public School Did Not Violate the Texas Open Meetings Act on March 7, 2011

Lastly, the TEA believes that the physical appearance by Mr. and Mrs. Cluff, along with Howard Jefferson, during the TEA's March 7, 2011 on-site audit may constitute a violation of the Texas Open Meetings Act. We respectfully disagree.

Mrs. Cluff and Mr. Jefferson are two members of the three-member charter holder board. Mrs. Cluff and Mr. Jefferson do not serve on the charter school board. Mr. Cluff is a member of the charter school board, but not the charter holder board. Thus, a quorum of the charter holder board was physically present, whereas a quorum of the charter school board was not present.

However, even though a quorum of the charter holder board was present, not every meeting between board members constitutes a "meeting" for purposes of the Texas Open Meetings Act. Instead, the Texas Open Meetings Act is only applicable to a meeting if five prerequisites are satisfied: (1) the body must be an entity within the executive or legislative

department of the state; (2) the entity must be under the control of one or more elected or appointed members; (3) the meeting must involve formal action or deliberation between a quorum of members; (4) the discussion or action must involve public business or public policy; and (5) the entity must have supervision or control over that public business or policy. See Beasley v. Molett, 95 S.W.3d 590, 605-06 (Tex. App.—Beaumont 2002); Gulf Reg'l Educ. Television Affiliates v. U. of Houston, 746 S.W.2d 803, 809-10 (Tex. App.—Houston [14th Dist.] 1988).

The presence of Mrs. Cluff and Mr. Jefferson at the March 7, 2011 audit cannot constitute a "meeting" for purposes of the Texas Open Meetings Act because the third and fifth prerequisites cannot be established. As to the third prerequisite, Mrs. Cluff's and Mr. Jefferson's presence did not involve any formal action or deliberation. Rather, Mr. Jefferson attended merely to observe the process and to assist the auditors as needed. And, Mrs. Cluff was present in her capacity as superintendent of The Varnett Public Schools, not as a board member, to assist the auditors as needed. They did not undertake any formal action or engage in any deliberations on behalf of The Varnett Public School. As a result, the March 7, 2011 audit was not subject to the Texas Open Meetings Act.

As to the fifth prerequisite, The Varnett Public School does not have any supervision or control over the audit process or the audit results. The audit falls squarely within the jurisdiction of the TEA. The TEA is the only entity that may exercise any supervision or control over the audit. The Varnett Public School's functions simply do not involve conducting TEA audits or issuing investigative reports. Because The Varnett Public School does not have supervision or control over educational audits, the March 7, 2011 audit was not subject to the Texas Open Meetings Act.

In conclusion, The Varnett Public School's off-campus board meetings and the attendance by Mrs. Cluff and Mr. Jefferson at the March 7, 2011 audit did not violate the Texas Open Meetings Act. The Varnett Public School provided timely and sufficient notice of all board meetings to the public. And, while the use of telephone conference call to conduct board meetings was a technical violation of the Act, the intent and purpose behind the Act was honored.

VI. DISBURSEMENT OF FUNDS

In the Report, the TEA alleges that The Varnett Public School did not maintain sufficient documentation for the disbursement of its funds. See Report, "Disbursement of Funds" at 12-14. It appears that the TEA is questioning every credit card purchase by The Varnett Public School from August 20, 2008 to January 19, 2010. Id. The Varnett Public School respectfully disagrees with the TEA's allegation.

A. The Varnett Public School Did Not Obtain a Credit Card Based on Representations Made by the TEA, its CPA, and its Independent Auditors.

At the outset of its findings, the TEA states that The Varnett Public School does not use a charter school credit card to make purchases. The TEA, in turn, acknowledges that The Varnett Public School uses a credit card issued to Mr. and Mrs. Cluff personally. The TEA appears to question The Varnett Public School's use of Mr. and Mrs. Cluff's credit card. The TEA, however, is the reason why The Varnett Public School does not have its own credit card.

After the TEA granted The Varnett Public School a charter in 1998, The Varnett Public School administration and staff began attending a number of workshops and training seminars. At that time, many of the workshops and training seminars were put on by Patsy O'Neill of the Texas Charter School Resource Center.

During the workshops and seminars, Ms. O'Neill would frequently bring TEA personnel and employees to the conferences to explain and to discuss the various rules and regulations pertaining to charter schools in Texas. Among the TEA personnel to attend these seminars were Ramon Medina and Nora Rainey.

At one or more of these conferences, Mr. Medina advised the attendees that charter schools should not have a credit card. As a result of this representation, The Varnett Public School did not obtain a credit card in its own name. Rather, The Varnett Public School used Mr. and Mrs. Cluff's personal credit card.

Prior to the grant of its charter, The Varnett Public School had operated a private school (the Varnett Academy, Inc.) for approximately fifteen (15) years. During that time period, The Varnett Public School had and used its own credit card in the name of the Varnett Academy, Inc. To this day, The Varnett Public School still maintains that same credit card account. Had Mr. Medina or anyone affiliated with the TEA not advised The Varnett Public School otherwise, The Varnett Public School would have obtained its own credit card at its inception and would have used that credit card over the past fifteen (15) years.

Instead, The Varnett Public School has used Mr. and Mrs. Cluff's personal credit card during the entirety of this time period. The Varnett Public School has not hidden or obscured its practice. In fact, The Varnett Public School's certified public accountant (Coveler & Associates, P.C.) and independent auditors (Gomez & Company and Frierson Sola & Associates) have been aware of and sanctioned this practice since 1998. Accordingly, The Varnett Public School has used Mr. and Mrs. Cluff's personal credit card for school-related expenditures based on the representations of the TEA, as well as its certified public accountant and independent auditors.

B. The Varnett Public School Did Not Violate Section 12.107(a) of the Texas Education Code

The TEA contends that The Varnett Public School violated Texas Education Code section 12.107(a) because it is unable to substantiate that its credit card purchases benefited its students. Section 12.107 only applies to funds administered by the State of Texas under the Foundation School Program. Tex. Educ. Code § 12.107. Section 12.107 does not apply to federal funds or to unrestricted funds acquired through a source other than the Foundation School Program. Thus, if the funds at issue were not provided through the Foundation School Program, section 12.107 is not applicable and could not have been violated.

Between 1998 and 2011, The Varnett Public School raised a total of $1,800,913 in unrestricted funds.[8] See The Varnett Schools, Inc. d/b/a The Varnett Public School, 1999 Audit Report at p. 4 (Aug. 7, 2000); The Varnett Schools, Inc. d/b/a The Varnett Public School, 2000 Audit Report at p. 5 (March 15, 2001); The Varnett Schools, Inc. d/b/a The Varnett Public School, 2001 Audit Report at p. 5 (Dec. 17, 2001); The Varnett Schools, Inc. d/b/a The Varnett Public School, 2002 Audit Report at p. 5 (Jan. 25, 2003); The Varnett Schools, Inc. d/b/a The Varnett Public School, 2003 Audit Report at p. 5 (Jan. 23, 2004); The Varnett Schools, Inc. d/b/a The Varnett Public School, 2004 Audit Report at p. 5 (Jan. 25, 2005); The Varnett Schools, Inc. d/b/a The Varnett Public School, 2005 & 2006 Audit Report at p. 5 (Jan. 24, 2007); The Varnett Schools, Inc. d/b/a The Varnett Public School, 2007 Audit Report at p. 3 (Aug. 27, 2008); The Varnett Schools, Inc. d/b/a The Varnett Public School, 2008 Audit Report at p. 3 (Jan. 14, 2009); The Varnett Schools, Inc. d/b/a The Varnett Public School, 2009 Audit Report at p. 3 (Jan. 12, 2010); The Varnett Schools, Inc. d/b/a The Varnett Public School, 2010 Audit Report at p. 3 (Jan. 13, 2011); The Varnett Schools, Inc. d/b/a The Varnett Public School, 2011 Audit Report at p. 3 (Jan. 19, 2012). These unrestricted funds are not subject to the provisions of section 12.107. Also, these unrestricted funds are consolidated with all other federal and state funding, such that all the funds are necessarily commingled together, as is expressly permitted under the No Child Left Behind Act of 2001. Thus, if the total amount of disbursements in question is less than $1,800,913, then The Varnett Public School cannot be found to have misused any Foundation School Program funds.

In the Report, the TEA questioned $1,504,980.51 in credit card charges. The amount of questioned funds is approximately $300,000 less than The Varnett Public School's unrestricted funding. Accordingly, even assuming for the sake of argument that all of the $1,504,980.51 was used for improper purposes, The Varnett Public School still would not have violated section 12.107 because none of the expenditures involved Foundation School Program funding.

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[8] In 2006, The Varnett Public School raised $56,474 in unrestricted funds. However, The Varnett Public School's expenses that year exceed its revenues. Therefore, the amount of unrestricted funds raised in 2006 was excluded from this calculation. For the remaining years, the total unrestricted funds raised amounts to $1,800,913.

C. The Varnett Public School Did Not Violate OMB Circular A-122, Attachment A(3)

Furthermore, the TEA contends that The Varnett Public School violated OMB Circular A-122, Attachment A(3) because The Varnett Public School is unable to substantiate that its credit card charges were reasonable and necessary. OMB Circular A-122 only applies to the use of federal funds by a non-profit organization. See U.S. Office of Management and Budget Circular A-122 (May 10, 2004) ("The principles do not apply to awards under which an organization is not required to account to the Federal Government for actual costs incurred.") Thus, if the funds at issue were not federal funds, then OMB Circular A-122 is not applicable and could not have been violated.

As set forth above, The Varnett Public School raised $1,800,913 in unrestricted funds between 1998 and 2011. These unrestricted funds are not subject to the provisions of OMB Circular A-122. Also, these unrestricted funds are consolidated with all other federal and state funding, such that all the funds are necessarily commingled together, as is expressly permitted under the No Child Left Behind Act of 2001. Thus, if the total amount of disbursements in question is less than $1,800,913, then The Varnett Public School cannot be found to have misused any federal funds.

In the Report, the TEA questioned $1,504,980.51 in credit card charges. The amount of questioned funds is approximately $300,000 less than The Varnett Public School's unrestricted funding. Accordingly, even assuming for the sake of argument that all of the $1,504,980.51 was used for improper purposes, The Varnett Public School still would not have violated OMB Circular A-122 because none of the expenditures involved federal funding.

D. The Varnett Public School Maintained Adequate Documentation

The TEA relies on Financial Accounting System Resource Guide, Module 10, section 1.8.2.6.5 to support its position that The Varnett Public School did not maintain adequate documentation. Section 1.8.2.6.5 provides that a charter school must maintain an "original and complete third-party document" to support disbursement of funds.

The Varnett Public School asserts that the use of an itemized receipt, as opposed to a final bill, is unnecessary to comply with this section. For each of the transactions at issue, the credit card statements alone provide the necessary information to show that the disbursement is a final transaction between The Varnett Public School and a third-party. In addition, the credit card statements provide the date of purchase, the time of purchase, the amount of purchase, and the place of purchase. This is the type of information that is needed to ensure that The Varnett Public School's funds are not being misappropriated.

Likewise, the monthly credit card statements are first reviewed and marked by Mrs. Cluff and Diana Jones (The Varnett Public School's Business Manager) to remove and to exclude any personal items that should not be paid by The Varnett Public School. These redacted statements are then given to The Varnett Public School's certified public accountant, together with attached backup invoices, to classify and to input into The Varnett Public School's accounting system, based on the attached backup. Mrs. Cluff reviews these statements to ensure that any and all purchases are ordinary, necessary and reasonable. The statements are also reviewed regularly by the board members to ensure that any and all purchases are ordinary, necessary, and reasonable.

Similarly, there is a conflict between section 1.8.2.6.5 and federal law. Specifically, the No Child Left Behind Act of 2001 and its corresponding federal regulations do not require The Varnett Public School to maintain itemized receipts or the type of documentation sought by the TEA here. See 34 C.F.R. § 80.20. The federal regulations only require documentation in any format or source to support the disbursement of funds. Id. In turn, the No Child Left Behind Act of 2001 and its regulations, as well as general principles under the U.S. Constitution's Supremacy Clause, dictate that the federal statutes and federal regulations control over a state administrative protocol, such as section 1.8.2.6.5. U.S. Const. Art. VI, Clause 2; 20 U.S.C. § 6311(c)(1); 34 C.F.R. § 200.29. The Varnett Public School's documentation satisfies the dictates of federal law. Thus, the TEA's attempt to impose contrary requirements on The Varnett Public School is ineffectual.

As miscellaneous items, the TEA alleges that the use of a credit card makes it "more likely" that State of Texas sales taxes may be passed onto The Varnett Public School, which is a tax-exempt entity. It is unclear whether the TEA is alleging that this has actually happened or just stating a general, unsupported concern. Either way, the concern is unmerited. In order to take advantage of its tax-exempt status, a tax exempt entity must present its exemption certificate to a vendor at the time of purchase. The use of a credit card does not hinder an entity's ability to present its exemption certificate.

Furthermore, the TEA states that, through the use of the credit card, American Express points are earned. It is unclear why this statement is included in the Report, or what rule is violated by this circumstance. However, when the earned American Express points are used to purchase goods and services for The Varnett Public School, it is a non-issue because The Varnett Public School receives the benefit. The Varnett Public School has used its rewards points to purchase items for itself. Accordingly, the use of rewards points has not violated any rules or regulations.

E. Specific Disbursements

In the Preliminary Investigative Report, the TEA broadly questions every credit card purchase between August 20, 2008 and January 19, 2011. This amounts to twenty-six pages of

questioned charges. However, the basis on which the TEA questions each respective charge is unclear: whether the charge is for an improper purpose, whether the charge is unreasonable or unnecessary, whether there is insufficient documentation for the charge, or some combination of the three.

Because The Varnett Public School cannot ascertain the underlying basis for each questioned charge, The Varnett Public School is unable to rebut or to accept the TEA's questions on a charge-by-charge basis. In this respect, The Varnett Public School is willing to review and to substantiate each specific charge, provided that the TEA can offer additional guidance.

The Varnett Public School acknowledges that a personal charge may have gone unnoticed accidentally during the redaction process.[9] In this event, The Varnett Public School is willing to correct the mistake and to ensure that The Varnett Public School is reimbursed in full. It is and has always heen The Varnett Puhlic School's policy to correct any accounting errors through a full reimbursement.[10]

In sum, The Varnett Public School's credit card purchases are each made to further its ultimate business purpose of operating the school to promote the best interests of its students. The Varnett Public School's purchases are all ordinary, necessary, and reasonable. The Varnett Public School has complied with the legally-applicable documentation requirements, and has not violated section 12.107 or OMB Circular A-122. In the event that The Varnctt Public School has accidentally paid for a charge unassociated with the operation of the school, The Varnett Public School wants to identify the error and to correct it; however, The Varnett Public School needs further clarification from the TEA in order to do so.

VII. <u>Travel Policies</u>

In the Preliminary Investigative Report, the TEA alleges that The Varnett Public School did not enforce its own internal travel policies on certain occasions by reimbursing employees for air travel in excess of economy class rates and by reimbursing its employees above the allocated daily ratc for meals. <u>See</u> Rcport, "Travel Policies" at 14-15. The Varnett Public School acknowledges that it did not always enforce its travel policies.

The Varnett Public School, however, permits exceptions to its general rule, and has frequently done so on behalf of its employees over the course of its history. In these situations, The Varnett Public School did reimburse employees for expenses above thc internal rates. All of

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9 In the Report, the TEA provides a brief description of the redaction process utilized by The Varnett Public School. <u>See</u> Report, "Disbursement of Funds" at 12.

10 In fact, the only time a similar issue was brought to The Varnett Public School's attention, The Varnett Public School corrected the mistake promptly and fully. <u>See</u> 2010 Audit Report at 19.

the expenses were incurred for legitimate reasons in furtherance of The Varnett Public School's interests, and the reimbursements were made for actual out-of-pocket expenses. These reimbursements were approved by the superintendent, who is charged with supervising the policies. And, the discretionary decisions to approve expenses above the daily rates were made on behalf of all employees, not just administrators or board members.

The Varnett Public School asserts that there was nothing illicit about its reimbursements, but recognizes that the reimbursements were in excess of the black-letter policies on file. The Varnett Public School intends to enforce its travel policies as written in the future. The Varnett Public School, therefore, requests that the TEA take these facts into account before issuing its final report.

VIII. Commingling of Funds and Records

In the Report, the TEA alleges that The Varnett Public School has commingled funds because it failed to maintain separate and distinct accounting, auditing, budgeting, reporting, and recordkeeping systems for its management and operation. See Report, "Commingling of Funds and Records" at 15-16. The entirety of the TEA's allegation is premised on the fact that The Varnett Public School does not have a separate credit card and, instead, uses the personal credit card account of Mr. and Mrs. Cluff for its purchases. The Varnett Public School contends that the TEA's position is incorrect.

As discussed in Section VI(A), The Varnett Public School did not obtain a credit card in its own name based on representations made by the TEA. Because of the TEA's representations, The Varnett Public School did not and has not ever obtained a separate credit card. Had the TEA not made this specific, express representation, The Varnett Public School would have obtained its own credit card years ago. Accordingly, the issue exists because Mr. and Mrs. Cluff thought they were complying with the TEA's instructions.

Regardless of the reason why The Varnett Public School did not obtain its own credit card, The Varnett Public School does maintain its own separate and distinct accounting, auditing, budgeting, reporting, and recordkeeping systems. Mr. and Mrs. Cluff's personal records, as well as the records of the Varnett Academy, Inc. and the Texas School Bus Company, are not maintained as part of The Varnett Public School's records. These systems are separate and distinct.

Apparently, the TEA is attempting to argue that the use of a credit card constitutes an "accounting system." The TEA's position is factually and legally flawed. From a factual standpoint, Mr. and Mrs. Cluff, as well as other Varnett Public School employees, use the credit card to purchase items for The Varnett Public School. Mr. and Mrs. Cluff also use the credit card to make purchases that are not for The Varnett Public School.

To ensure that The Varnett Public School only pays for its school-related purchases, Mrs. Cluff and Ms. Jones separate personal charges from school charges. The Varnett Public School has used this procedure for the entirety of the time that it has been a charter school. Prior to this Report, the TEA has never expressed any objection or concern with The Varnett Public School's use of Mr. and Mrs. Cluff's credit card.

Likewise, in every audit report from 1999 through 2011, the independent auditor determined that the procedure used by The Varnett Public School did not constitute a material weakness or a significant deficiency.[11] In addition, The Varnett Public School's certified public accountant was aware of and approved this procedure. Had The Varnett Public School been advised that its procedures were a material weakness or a significant deficiency, The Varnett Public School would have implemented a new procedure.

From a legal standpoint, the use of a mutual credit card does not constitute the commingling of separate accounting systems. An accounting system is a system of records that demonstrates revenues realized and expenditures made over a given time period. The Varnett Public School maintains its own records of revenue realized and expenditures made separate and apart from that of other third-parties.[12]

The TEA references three (3) specific expenditures to support its position, namely a charge at Pappa's Seafood, a charge from Levenger Catalog, and a charge from Paychex of New York, L.L.C. The charges from Pappa's Seafood and Levenger Catalog were made on behalf of The Varnett Public School and, therefore, paid for by funds from The Varnett Public School. The charge from Paychex of New York, L.L.C., however, was a charge incurred on behalf of the Varnett Academy, Inc... It should not have been attributed to The Varnett Public School and has been reimbursed. The fact that a charge was mistakenly attributed to The Varnett Public School does not demonstrate a commingling of accounting systems, but rather a human error that has been remedied.

In conclusion, The Varnett Public School does maintain its own separate and distinct accounting, auditing, budgeting, reporting, and recordkeeping systems. And, significantly, The Varnett Public School's use of a mutual credit card was authorized by the TEA at the outset and

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11 In the 2012 Audit Report, The Varnett Public School's independent auditor recommended that The Varnett Public School obtain its own credit card and that all charges to the credit card have pre-approval prior to purchasing. See The Varnett Schools, Inc. d/b/a The Varnett Public School, 2012 Audit Report at p. 20 (Jan. 28, 2013). At present, The Varnett Public School has applied for and has been approved for its own credit card. The Varnett Public School intends to implement the independent auditor's recommendations.

12 The Varnett Public School does acknowledge that the use of a mutual credit card may cause charges to be mistakenly attributed to the wrong accounting system. Therefore, The Varnett Public School believes that the acquisition of a credit card in its own name is beneficial.

continuously approved by The Varnett Public School's certified public accountant and independent auditor.

IX. VEHICLES PROVIDED BY THE CHARTER SCHOOL

In the Preliminary Investigative Report, the TEA contends that Mr. and Mrs. Cluff use vehicles owned by The Varnett Public School without the approval of the charter school board, in violation of Texas Penal Code section 39.02. See Report, "Vehicles Provided By the Charter School" at 16-17. The TEA's allegation is factually and legally incorrect. The Varnett Public School did approve the purchase of the vehicles for use by Mr. and Mrs. Cluff. See The Varnett Public School, Fact Sheet (Jan. 12, 2010); The Varnett Public School, Board of Directors, Meeting Minutes (Jan. 12, 2009). Because the TEA's finding is based on a faulty factual premise, The Varnett Public School disagrees with the TEA's conclusion.

X. GIFTS OF PUBLIC FUNDS

In the Report, the TEA asserts that The Varnett Public School inappropriately provided donations to third-parties, namely charitable donations to the Houston Citizens Chamber of Commerce, the United Negro College Fund, the National Black Caucus, and a board member, in violation of the Texas Constitution, the Texas Education Code, and the Texas Administrative Code. See Report, "Gifts of Puhlic Funds" at 17. The Varnett Public School disputes the TEA's position.

A. The Varnett Public School Was Permitted to Donate Its Unrestricted Funds

The TEA relies on three legal sources to support its argument that The Varnett Public School improperly donated funds: Article III, section 52 of the Texas Constitution; Texas Education Code section 12.107; and Title 19, section 100.1043 of the Texas Administrative Code. All three of these legal sources only concern the donation of state funds. They do not apply to the donation of federal or unrestricted funds. Thus, if the donations at issue were not made with state funds, none of the three legal sources are applicable and could not have been violated.

As discussed in Section VI, The Varnett Public School raised a total of $1,800,913 in unrestricted funds from 1998 through 2011. These unrestricted funds are not subject to the provisions of Article III, section 52, section 12.107, or section 100.1043. Also, these unrestricted funds are consolidated with all other federal and state funding, such that all the funds are necessarily commingled together, as is expressly permitted under the No Child Left Behind Act of 2001. Thus, if the total amount of disbursements in question is less than $1,800,913, then The Varnett Public School cannot be found to have improperly donated state funds.

In the Report, the TEA questioned $47,249 in donations. The amount of questioned funds is well below The Varnett Public School's unrestricted funding.[13] Accordingly, even assuming for the sake of argument that all of the $47,249 was donated, The Varnett Public School still would not have violated the referenced legal authorities because none of the donations involved state funding.

B. The Varnett Public School Self-Reported and Was Reimbursed for Its Donations to the National Black Caucus and a Board Member

In 2008, The Varnett Public School donated $25,000 to the National Black Caucus and purchased a juke box for $5,249 as a gift for a board member. The Varnett Public School's independent auditor brought these issues to the TEA's attention and The Varnett Public School's attention in the 2010 Audit Report. See The Varnett Schools, Inc. d/b/a The Varnett Public School, 2010 Audit Report at p. 19 (Jan. 13, 2011).

Once this issue was made known to The Varnett Public School, Mr. and Mrs. Cluff acknowledged the mistake and fully reimbursed The Varnett Public School—without any action by the TEA. Mr. and Mrs. Cluff reimbursed The Varnett Public School months before the TEA conducted its on-site audit and approximately a year-and-a-half before the TEA issued its Preliminary Investigative Report. Mr. and Mrs. Cluff, as well as The Varnett Public School, did not possess any illicit intent when they made these donations. The Varnett Public School requests that the TEA takes the prompt and full reimbursement and self-reporting of the violation into account when issuing its final report.

C. The Varnett Public School Did Not Make a Donation to the Houston Citizens Chamber of Commerce.

The TEA contends that The Varnett Public School made a $15,000 donation to the Houston Citizens Chamber of Commerce. The Varnett Public School acknowledges that it paid $15,000 to the Houston Citizens Chamber of Commerce; however, this payment was not a donation. Instead, the $15,000 payment was made as an advertising expense to market The Varnett Public School. As a result of this payment, the Houston Citizens Chamber of Commerce has recognized The Varnett Public School in its brochures and publications from that date through the present.

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[13] Even when the $47,249 in questioned donations is added to the $1,504,980.51 in questioned credit card charges, the sum still falls below The Varnett Public School's $1.8 million in unrestricted funds.

XI. Nepotism

In the Report, the TEA indicates that a concern regarding nepotism was not substantiated. See Report, "Nepotism" at 18. The Varnett Public School agrees that it did not violate any anti-nepotism rules. The Varnett Public School, therefore, requests that the TEA exclude any reference to this unsubstantiated concern in its final report.

XII. Accounting and Budgeting

In the Report, the TEA alleges that The Varnett Public School did not comply with state and federal regulations regarding its accounting functions and budget review. See Report, "Accounting and Budgeting" at 18-19. It appears the entire factual basis for the TEA's finding is the belief that The Varnett Public School does not update or review its budget, or compare its budget with actual expenditures, on a continuous basis.[14] The TEA's factual premise is incorrect. The Varnett Public School, therefore, disagrees with the TEA's conclusion.

The Varnett Public School does review, compare, and update its budget on a regular, consistent basis. Generally, The Varnett Public School begins its budget preparations annually in the late Spring. Mrs. Cluff works with The Varnett Public School's certified public accountant to develop the budget by considering past expenses and future expenditures. After a proposed budget is finalized, it is presented to the board members. The hoard members then review, revise, and approve the budget. The budget is reviewed as necessary throughout the year. Likewise, the board members review The Varnett Public School's financial statements regularly at board meetings. In doing so, The Varnett Public School is aware of its budget allocations, its actual expenditures, and how its actual expenditures compare to its budget allocations. This budget-review process has worked well for The Varnett Public School. In fact, for all the years in question, The Varnett Public School's revenues far exceeded its expenses.

Because The Varnett Public School does compare its actual expenditures to its budget allocations, The Varnett Public School is in compliance with the applicable regulations, namely 34 C.F.R. § 80.20.

XIII. Procurement of the Administration Building

In the Report, the TEA alleges that The Varnett Public School did not comply with Chapter 271 of the Texas Local Government Code when it contracted for the work in connection with the acquisition of its Administration Building. See Report, "Procurement of the

[14] In the Report, the TEA contends that Mrs. Cluff "stated that she had not updated her budget or reviewed the budget-to-actual expenditures since October 2010." Mrs. Cluff did not make this statement.

Administration Building" at 19. The Varnett Public School disputes the TEA's finding for several reasons.

A. Chapter 271 of the Local Government Code is Not Applicable

First, Chapter 271 of the Local Government Code is not applicable in this instance. Instead, Chapter 2254 of the Texas Government Code controls.

Chapter 2254 permitted The Varnett Public School to obtain the services at issue without the necessity of performing a competitive-bid process. See Texas Gov't Code §§ 2254.001-.004. Because the services at issue fall within the purview of engineering, architectural, and surveying work, The Varnett Public School was permitted to retain these services (a) on the basis of demonstrated competence and qualifications to perform the services, and (b) for a fair and reasonable price. Tex. Govt. Code § 2254.003. In retaining these services, The Varnett Public School determined that the various independent contractors were competent and qualified and that the price was fair and reasonable.

Before retaining these independent contractors, The Varnett Public School did meet with multiple bidders, including Mobile Modular and Ramtech Building Systems. In considering which entity to retain, The Varnett Public School determined that the prices and services of the three entities were similar. In fact, The Varnett Public School had retained the services of each of these entities previously and knew that each of these entities provided competent services at a fair and reasonable price.

Ultimately, The Varnett Public School selected CoMark Building Systems, Inc. because it was the only entity that could meet the timing deadlines of the project. In selecting CoMark Building Systems, Inc., The Varnett Public School considered the following factors: (a) the purchase price, (b) the reputation of the vendors and that of their goods and services, (c) the quality of the vendors' good and services, (d) the extent to which the goods and services satisfied The Varnett Public School's needs, (e) the vendors' past relationships with the vendors, and (f) the total long-term cost to obtain the goods and services. See The Varnett Public School, FACT Sheet (April 10, 2008). For all the services at issue, The Varnett Public School satisfied the requirements under Chapter 2254.

B. The Competitive Bid Laws May Not Be Applicable at All

Secondly, it is unclear whether the transactions at issue are subject to any competitive-bid laws at all. Ultimately, the Varnett Academy, Inc. ended up being the purchaser of these services. The Varnett Academy, Inc. is not subject to any competitive bid laws. Thus, the use of a competitive-bid process may be a non-issue in this matter.

C. The Varnett Public School Believed That It Was in Compliance with Chapter 271 of the Local Government Code

Third, assuming for the sake of argument that Chapter 271 is the applicable legal standard, The Varnett Public School believed that its retention of CoMark Building Systems, Inc. did satisfy any and all applicable competitive-bid laws. In Texas, a governmental body may satisfy its competitive bid law if it retains the services of a state-approved vendor. See Texas Local Government Code §§ 271.082-.083; 19 Texas Adm. Code § 100.1201; Comptroller of Public Accounts, State of Texas Cooperative Purchasing Manual.

During the negotiation process, CoMark Building Systems, Inc. advised The Varnett Public School that it was a state-approved vendor. The Varnett Public School believed this representation and, therefore, thought that it was in compliance with the competitive bid laws. The Varnett Public School, however, now knows that CoMark Building Systems, Inc.'s representation was incorrect. At the time, The Varnett Public School reasonably believed that it was in compliance with Chapter 271. In conclusion, The Varnett Public School satisfied the applicable competitive-bid requirements.

XIV. TEA AUDITOR FINDINGS—AMERICAN REINVESTMENT AND RECOVERY ACT

In the Report, the TEA alleges that The Varnett Public School violated 34 C.F.R. § 80.20(b)(4) because The Varnett Public School did not incorporate a hudget into its accounting system. See Report, "TEA Auditor Findings—American Reinvestment and Recovery Act" at 20. The Varnett Public School disputes the TEA's allegation.

Section 80.20(b)(4) does not impose any requirement that The Varnett Public School must incorporate a budget into its accounting system. Rather, section 80.20(b)(4) only provides that The Varnett Public School must compare actual expenditures with budgeted amounts. See 34 C.F.R. § 80.20(b)(4) ("Actual expenditures or outlays must be compared with budgeted amounts for each grant or subgrant.") The Varnett Public School satisfies this requirement.

The Varnett Public School sets a budget each year. Mrs. Cluff periodically and routinely reviews and compares the actual expenditures with the budgeted amounts. In turn, The Varnett Public School's certified public accountant reviews and compares the actual expenditures with the budgeted amounts. Likewise, Mrs. Cluff personally meets with The Varnett Public School's certified public accountant to compare actual expenditures with the budgeted amounts. At the monthly board meetings, Mrs. Cluff presents the financial statements to the board, which independently reviews and compares the actual expenditures with the budgeted amounts. This system has worked extremely well for The Varnett Public School. Accordingly, The Varnett Public School has not violated section 80.20(b)(4).

Furthermore, the TEA may not impose any additional accounting or fiseal requirements on The Varnett Public School beyond those set by federal law. The No Child Left Behind Act of 2001, and its applicable regulations, prevents States from imposing additional accounting or fiscal requirements separate and apart from the federal requirements on The Varnett Public School. See 20 U.S.C. § 6311(c)(10); 34 C.F.R. § 200.29. To the extent that the TEA is seeking to impose additional requirements on The Varnett Public School, those additional requirements are not valid. Because The Varnett Public School has not violated section 80.20, The Varnett Public School disagrees with the TEA's findings.

XV. Required Actions

At the conclusion of the Preliminary Investigative Report, the TEA lists five (5) Required Actions. The first required action provides that The Varnett Public School "must conduct a comprehensive review of internal control policies and procedures and make the necessary modifications to address the findings contained in this report." The Varnett Public School intends to do so and has already conducted a training seminar on January 26, 2013 in which board members were provided training on the Texas Open Meetings Act, internal governance and operations, and financial operations. Also, The Varnett Public School would welcome the TEA's guidance and input on how best to conduct this review.

The second required action provides that The Varnett Public School "should ensure that financial records and documentation are consistent with FASRG requirements." The Varnett Public School intends to do so and would welcome the TEA's guidance and input on how best to do so.

The third required action provides that The Varnett Public School "should obtain a credit card in its name or use purchase orders and checks to obtain school-related supplies and materials." The Varnett Public School has already applied for and been approved for a credit card in its own name.

The fourth required action provides that The Varnett Public School "should provide Title I, Part A training for planning team members, develop a comprehensive set of materials for the planning team to use during the annual review of their schoolwide plans, and conduct a technical assistance workshop for existing schoolwide schools on required plan components and timeframes for plan review and revision." The Varnett Public School intends to do so and would welcome the TEA's guidance and input on how best to do so.

The fifth required action provides that The Varnett Public School "should ensure that each Title I, Part A schoolwide campus develop a schoolwide plan that incorporates the school's vision and mission statements, a concise version of the school profile, and a summary of the needs assessment, and also addresses how the 10 components will be addressed through the

established goals and the implementation of rcsearch-based strategies." The Varnett Public School intends to do so and would welcome the TEA's guidance and input on how best to do so.

<u>CONCLUSION</u>

The Varnett Public School is prepared to address any remaining concerns the TEA may have and is open to discussing the differences of opinion that this Response addresses. Both our firm and our client acknowledge the wide range of solutions available to the TEA and genuinely hope that the parties will be able to agree upon a resolution that enables The Varnett Public School to continue serving the students and community in the exemplary and compassionate way it has for the past thirty years.

In the event that the TEA has any additional inquiries, please feel free to contact us at your earliest convenience. Thank you for your prompt and professional attention to this matter.

Sincerely,

Rusty Hardin